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James M. Higbee

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COMMUNITY AND SEPARATE PROPERTY INTERESTS IN LIFE INSURANCE PROCEEDS: A FRESH LOOK

This comment examines the difficult problem of characterizing the proceeds of a life insurance policy as separate or community property where the policy insures the life of a spouse and premiums have been paid with both separate and community funds.¹ The problem commonly arises when a person takes out a life insurance policy while single, pays the first few premiums from separate funds, and then maintains the policy with community funds following marriage.² Upon death of the insured spouse, the characterization of the proceeds as separate or community or partially both is significant for two reasons. Not only may such characterization determine the amount of policy proceeds that the insured may dispose of through beneficiary designation, but it will also affect the determination of the estate and inheritance tax liability of the deceased spouse.

A majority of the courts in community property jurisdictions³ that have considered this issue have concluded that the proceeds are the separate property of the insured spouse because he or she paid the first premium, or "bought" the policy.⁴ Other courts have divided the proceeds between the community and separate estates in proportion to the number of years each paid premiums.⁵ This comment suggests that neither of these approaches is appropriate. Rather, when both separate and community estates have paid premiums on a life insurance policy, its cash value,⁶ if any, should be characterized as separate

1. In the most common factual situation, the husband has been the insured policyowner. However, the principles discussed herein are equally applicable when the wife is the insured.

2. A similar problem can arise when a policy is taken out during marriage by one spouse and it is not disposed of in a subsequent divorce decree. If the owner continues the policy premium payments after divorce, allocation between community and separate interests again may be required. See notes 116-19 and accompanying text *infra*.

3. The following states comprise the American community property jurisdictions: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington.

4. This is the inception of title rule which has been accepted by the supreme courts of Arizona, Louisiana, New Mexico, and Texas. See Part II-A *infra*.

5. This is the apportionment rule which has been accepted in California and Washington. See Part II-B *infra*. Courts in the remaining two community property states, Nevada and Idaho, have not yet been confronted with a case requiring them to choose a rule allocating insurance proceeds between community and separate estates.

6. The cash value of life insurance (or cash surrender value as it is also called)

and community according to the number of years each estate paid the premiums, and proceeds attributable to the risk or protection portion⁷ of the policy should be allocated according to the character of the estate which paid the *last* premium before death.

I. THE NATURE OF LIFE INSURANCE AS PROPERTY

A. *Term Insurance*

There are two basic types of life insurance: term insurance and cash value insurance. The former insures one's life for a stated period or term of years. Term insurance has other distinctive characteristics as well. First, the premiums purchase protection only from risk of death; they do not build up a cash surrender value.⁸ In this respect, term life insurance is analogous to fire or auto insurance.⁹ Much term insurance is also renewable. This means that at the end of the term it may be renewed for a limited number of successive terms; the insured is not required to show evidence of insurability.¹⁰ Term insurance may also be convertible. The convertibility feature allows the policyholder to exchange his term insurance for a cash value policy without evidence of insurability.¹¹ Term insurance can be purchased as an individual policy or by participation in a group life insurance plan.¹²

is the value of the cumulative savings or investment portion of the policy. See Part I-B *infra*.

7. The risk or protection portion of the policy is the face value minus the cash value, if any. The face value of a policy is the amount which will be paid to the beneficiaries upon the insured's death.

8. Term policies have little or no cash value. See note 124 *infra*.

9. Life insurance, however, is not a contract for indemnity as is fire or auto insurance. An indemnity contract pays only the amount of the insured's loss, regardless of the face amount of the policy. A life insurance policy, on the other hand, is a contract to pay a stated sum, the face amount, on the insurer's death. See D. MCGILL, *LEGAL ASPECTS OF LIFE INSURANCE* 23 (1959).

10. Evidence of insurability may include demonstration of good health, verified by a physical examination, and proof of being younger than a certain maximum age. See J. MACLEAN, *LIFE INSURANCE* 249-87 (9th ed. 1962).

11. The conversion privilege allows one who is otherwise uninsurable to purchase insurance. For example, assume one purchases a non-renewable ten-year term policy and becomes uninsurable sometime during the ten years. If the policy is convertible, then sometime before the expiration of his term policy the insured can convert it into a whole life policy of the same face amount under which he can remain insured until age 100. If the term plan is not convertible, upon expiration of the ten-year term policy, the insured would be without insurance, and being uninsurable, he could obtain none.

12. Group term life insurance covers a group of people under a master policy

For purposes of this discussion, the most important feature of term insurance is that it exists only by virtue of each advance premium payment. Protection for the coming year depends exclusively upon payment of an advance premium. The length of time the insured has had the policy and the number of premiums previously paid are irrelevant. If the term passes without the insured's death, the protection purchased expires without loss. The insured has had the benefit of protection for the year and it has been "used up." He must pay another premium to enjoy further protection. Although this principle appears simple, no state supreme court in a community property jurisdiction has recognized it.¹³

B. Cash Value Insurance

Like term insurance, cash value insurance¹⁴ contains a risk or protection element. In addition to this protection element, however, cash

which is usually issued without a medical examination of the individual participants. Typically, it is issued to an employer for the benefit of employees. The individual members of the group hold certificates rather than policies as evidence of their insurance. See INSTITUTE OF LIFE INSURANCE, LIFE INSURANCE FACT BOOK 117 (1975) [hereinafter cited as LIFE INSURANCE FACT BOOK]. Virtually all group insurance is renewable term insurance. In 1974, 99.2% of group life insurance in force in the United States was group term life insurance. *Id.* at 24. See also D. GREGG, GROUP LIFE INSURANCE 2, 3, 82, 83 (3d ed. 1962).

13. The Arizona appellate courts, however, have accepted this reasoning for dealing with term insurance policies. *Lock v. Lock*, 8 Ariz. App. 138, 444 P.2d 163 (1968); *Gaethje v. Gaethje*, 7 Ariz. App. 544, 441 P.2d 579 (1968). See notes 100 & 101 and accompanying text *infra*.

14. The primary types of cash value policies are:

a. *Whole Life Insurance*: In a whole life policy premium payments continue until death or age 100. For new policies of the same face value at any given age, whole life premiums are higher than term premiums because the whole life policy contains, in addition to the protection element, a savings or investment element that grows continually throughout the life of the policy until it equals the face value of the policy at age 100. This savings element is the policy's cash value. If one cancels a whole life policy before payments are completed, the policy owner has the right to the current cash value of the policy. Whole life is also known as ordinary life and straight life.

b. *Endowment Life Insurance*: In an endowment policy the insurance company promises to pay the insured or his designee the face value of the policy at the end of a stated period of time (e.g., in 20 years or at age 65), or to pay the beneficiary the face value if the insured dies before the specified period ends. When the full time period has run and the face value paid to the insured or designee, the endowment is said to have matured. As with whole life insurance, the insured can withdraw any cash value accumulated if the policy is cancelled.

c. *Paid-up Life Insurance*: In a paid-up insurance policy the insured makes a lump sum payment or pays a designated number of installments. When such payments are completed additional premiums are not required and the policy remains in effect until its maturity which is either at the insured's death or at age 100, whichever occurs first.

value insurance also contains a savings or investment portion.¹⁵ Throughout the life of the policy, and as long as premiums are paid, the cash value grows. Thus, cash value is the equity which builds up over time by reason of the premium payments. The policyowner can borrow against this equity from the insurance company and can receive its value if he cancels the policy. Even when premiums are not

As in the other types of cash value policies, the insured has a right to receive the policy's accumulated investment portion upon cancellation.

For a more complete discussion of these three types of policies see S. HUEBNER & K. BLACK, JR., *LIFE INSURANCE* chs. 6 & 7 (8th ed. 1972); *THE CONSUMERS UNION REPORT ON LIFE INSURANCE* ch. 2 (rev. ed. 1972).

15. This aspect of cash value insurance has been described variously by commentators on insurance. In J. BELTH, *THE RETAIL PRICE STRUCTURE IN AMERICAN LIFE INSURANCE* 35 (1966), the author suggests that "[cash value insurance] should come to be viewed consistently as a combination of savings and yearly renewable term insurance." Another author notes:

Straight life insurance . . . may be considered to be a combination of decreasing term insurance (the pure protection element) and an increasing savings or investment element which equals the face value at age 100.

Other forms of whole life insurance and endowment insurance may be viewed in the same way

Williams, *Contracts—Whole Life and Endowment*, in *LIFE AND HEALTH INSURANCE HANDBOOK* 66, 70 (3d ed. 1973). See also *THE CONSUMERS UNION REPORT ON LIFE INSURANCE* ch. 2 (rev. ed. 1972). As a consequence of this division of cash value insurance into two parts, the policyholder does not actually "own" protection equivalent to the face value of the insurance:

In viewing the cash value as an asset, the policyholder must then realize that the amount of actual life insurance protection he owns at any given time is the face amount of the policy less the cash value at that time, and *not* the entire face amount. This concept is critical to a clear understanding of the nature of life insurance.

J. BELTH, *A REPORT ON LIFE INSURANCE* 11 (1967) (emphasis in original). See also notes 120, 126, 138 & 139 and accompanying text *infra*.

Insurance texts generally treat cash value life insurance in this manner. See, e.g., I W. BEADLES & J. GREIDER, *PRINCIPLES OF LIFE INSURANCE* 31-32, 36-39 (rev. ed. 1972); S. HUEBNER & K. BLACK, JR., *supra* note 14, at 10-11, 88-89, 94-95; J. MACLEAN, *supra* note 10, at 14-16; A. MOWBRAY, R. BLANCHARD & C. WILLIAMS, JR., *INSURANCE: ITS THEORY AND PRACTICE IN THE UNITED STATES* 307 (6th ed. 1969). See also J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 2 (1965); J. BELTH, *LIFE INSURANCE: A CONSUMERS' HANDBOOK* 23 (1973); G. REYNOLDS, *THE MORTALITY MERCHANTS* chs. 2 & 3 (1968).

Commentators on marital rights and life insurance also recognize the dual nature of cash value life insurance. See, e.g., Stephens, *Life Insurance and Community Property in Texas—Revisited*, 10 SW. L.J. 343, 350 (1956); Comment, *Life Insurance as Alimony—Income Tax Aspects*, 34 LA. L. REV. 114, 118 n.30 (1973).

The recent trend toward price disclosure in life insurance is based on the fact that, for practical purposes, cash value insurance is composed of protection and savings elements. See Belth, *Life Insurance Price Measurement*, 57 KY. L.J. 687 (1969); Belth, *Price Disclosure in Life Insurance*, 1972 WIS. L. REV. 1054, 1054-55; Kimball & Rapaport, *What Price "Price Disclosure"? The Trend to Consumer Protection in Life Insurance*, 1972 WIS. L. REV. 1025, 1027-29.

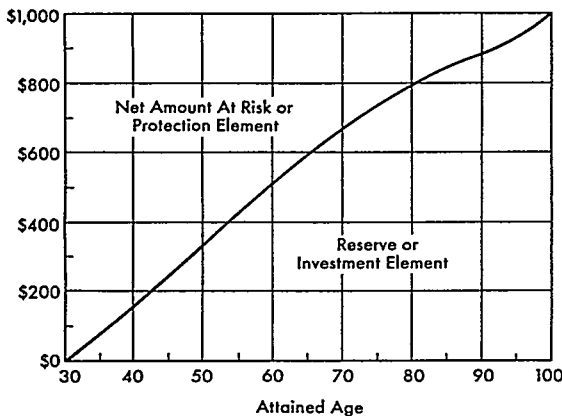
The following diagram illustrates the relationship between the two segments of a whole life policy. The amount of cash value closely approximates the amount of the reserve element.

paid this equity continues to exist, although it ceases to grow. As is true with respect to term insurance, however, the protection portion of cash value insurance exists only by reason of the last premium payment.¹⁶ Thus, cash value life insurance has both a temporary protection (or term insurance) portion that *must* be paid for annually,¹⁷ and a permanent cumulative investment portion.

II. THE DISPOSITION OF LIFE INSURANCE PROCEEDS WHEN PREMIUMS HAVE BEEN PAID WITH BOTH SEPARATE AND COMMUNITY FUNDS

A. *The Inception of Title Rule and Its Application to Life Insurance*

Under Spanish community property law, the spouse who initiates acquisition of property before marriage and completes payment after



S. HUEBNER & K. BLACK, JR., *supra* note 14, at 10.

16. The original form of the policy can be maintained only through continued premium payments. That is, the cash value will continue to increase, the protection element will continue to exist, and the original face amount will continue to be maintained only if regular payments are made.

17. An exception does exist to this general rule. In 1974, 5.5% of the total face amount of individual life insurance in effect in the U.S. consisted of policies in which all payments had been made. Of the total amount in effect, paid-up whole life consisted of 3.9% and extended term consisted of 1.6%. The protection portion of these policies did continue to exist independent of future payments. See LIFE INSURANCE FACT BOOK at 34.

marriage acquires separate property.¹⁸ Louisiana, New Mexico, and Texas have explicitly adopted this inception of title rule in instances where part of the consideration is paid before marriage, title is transferred, and the balance of the consideration is paid during coverture with community funds.¹⁹ In these circumstances, the community estate is entitled to reimbursement for the funds it paid.²⁰ These states also hold that property acquired with funds expended both during marriage and after dissolution of the community by death or divorce is community in character. Likewise, the separate estate can be reimbursed for expenditures made from it.²¹

Courts that apply the inception of title rule to the characterization of life insurance proceeds advance several arguments to support its use. Such arguments, however, are based upon questionable precedent and faulty logic. None survive careful analysis in light of the character of life insurance.

I. The In re Moseman precedent

Each of the state courts that have adopted the inception of title rule in the life insurance context has relied upon the leading 1886 decision of *In re Moseman*.²² In *Moseman* the Louisiana Supreme Court

18. This principle is applicable to both real and personal property. See W. DEFUNIAK & M. VAUGHN, PRINCIPLES OF COMMUNITY PROPERTY § 64, at 130 & n.96 (2d ed. 1971) [hereinafter cited as DEFUNIAK & VAUGHN].

19. *Baker v. Baker*, 209 La. 1041, 26 So. 2d 132 (1946); *Hollingsworth v. Hicks*, 57 N.M. 336, 258 P.2d 724 (1953); *Colden v. Alexander*, 141 Tex. 134, 171 S.W.2d 328 (1943); DEFUNIAK & VAUGHN § 64. Although deFuniak disagrees, Professor Harry Cross believes Washington also may have adopted this rule. See Cross, *The Community Property Law in Washington*, 49 WASH. L. REV. 729, 758-63 (1974). In Arizona the rule adopted is not entirely clear. Idaho and Nevada hold that property is part separate and part community in proportion to the amounts of the respective funds used if separate and community funds are used in its acquisition. See DEFUNIAK & VAUGHN § 64, at 133-34.

20. See DEFUNIAK & VAUGHN § 64, at 133.

21. See *id.* § 68.2, at 152.

22. 38 La. Ann. 219 (1886). In *McCurdy v. McCurdy*, 372 S.W.2d 381 (Tex. Civ. App. 1963), the court followed *Moseman* after citing it with approval. The Texas Supreme Court approved the holding of *McCurdy* by refusing a writ of error. Under Texas practice, a writ of error is refused "where the judgment of the Court of Civil Appeals is a correct one and where the principles of law declared in the opinion of the court are correctly determined . . ." TEX. R. CIV. P. 483 (1976). In *Rothman v. Rumbeck*, 54 Ariz. 443, 96 P.2d 755 (1939), the Arizona Supreme Court relied on *Verneuille's Succession*, 120 La. 605, 45 So. 520 (1908), a Louisiana life insurance case, as authority for Arizona's acceptance of the inception of title rule. *Verneuille's Succession* in turn relied on *Moseman*. In *In re White's Estate*, 43 N.M. 202, 89 P.2d

held that when a life insurance policy in which the insured's estate is beneficiary is taken out before marriage, and subsequent premiums are paid with community funds after marriage, the policy proceeds are the separate property of the insured spouse. The court reasoned that the ownership and contract rights of the life insurance contract vested on the date of the first premium payment. Thus, where the first premium was paid from the insured's separate funds, subsequent community payments could not divest the interest of the insured's separate estate.

The reasoning in *Moseman* is faulty because the court misunderstood the nature of the life insurance contract. The court failed to recognize that the insurance contract is unilateral rather than bilateral, and that premiums are periodic payments, not installment payments. An insurance policy is not a bilateral contract because the insured does not promise in advance to pay premiums as they become due. Thus, failure to make such payments on the part of the insured does not give rise to legal liability for breach of contract.²³ Furthermore, the insured cannot bind the insurance company merely by promising to pay the premiums, but must perform the act of paying to bind the company. These characteristics of the life insurance contract stem from the general principle of contract law that a unilateral contract does not arise until the required act is performed. In a unilateral contract, performance is acceptance.²⁴

The *Moseman* court's failure to recognize the unilateral nature of the insurance contract resulted in two erroneous conclusions. First, the court determined that *all* the rights of the insured in the insurance contract, including the death benefit under which the insured died

36 (1939), the New Mexico Supreme Court relied on G. MCKAY, A TREATISE ON THE LAW OF COMMUNITY PROPERTY §§ 479-80 (2d ed. 1925), as authority for its acceptance of the inception of title rule. MCKAY quoted *Moseman* approvingly and relied on both *Moseman* and *Succession of Le Blanc*, 142 La. 27, 76 So. 223 (1917), a Louisiana case that followed the reasoning of *Moseman*.

23. The rule has thus been stated:

A life insurance policy is a unilateral contract. Only the insurer makes any legally enforceable promises. The insured does not even promise to pay premiums. It is impossible for him to be held for breach of contract. Payment of premiums is merely a condition precedent for the continuation of the promise of the insurer in its present form.

R. MEHR & R. OSLER, MODERN LIFE INSURANCE 149 (3d ed. 1961). See also D. MCGILL, LEGAL ASPECTS OF LIFE INSURANCE 22 (1959).

24. See note 28 *infra*.

years later, were created when the one *original* premium was paid.²⁵ The second and related error was the court's conclusion that the insured acquired the contract rights from the date of the first premium payment "subject to the condition of compliance with his own engagements to pay the premiums."²⁶ The court reasoned that the subsequent premium payments were merely conditions precedent to the enforcement of a bilateral contract which had been created years before.²⁷ According to the court, the rights of the parties were determined at the time the original contract was made because the condition precedent had occurred. In actuality, because the insurance contract is properly characterized as a unilateral contract, the condition precedent and the payment of consideration are performed simultaneously.²⁸ The insured makes no promise to pay any future premiums and there is no corresponding relation back of his rights to the date of the first premiums payment. No retroactive rights or obligations arise.

25. The court stated:

The contract [of insurance] creates certain rights and obligations which spring into existence the moment it is formed. Thus, at the date of the policies, Moseman acquired for himself the right to receive, at his death, through his executors, administrators or assigns, the sums stipulated to be paid, subject to the condition of compliance with his own engagements to pay the premiums as they fell due.

This condition having been complied with, "has a retrospective effect to the day that the engagement was contracted." C.C. 2041. The character of the interest and of the ownership thereof takes its impress from the date of the contract.

38 La. Ann. 219, 221 (1886).

26. *Id.*

27. The common law of contracts recognizes that with the performance of a condition precedent, all contractual obligations that the parties previously entered into become fixed and absolute. J. CALAMARI & J. PERILLO, *THE LAW OF CONTRACTS* § 138 (1970). The civil code of Louisiana contains a similar provision, which was relied upon by the court in *Moseman*: "The condition being complied with, has a retroactive effect to the day that the engagement was contracted" LA. CIV. CODE art. 2041 (West 1972). However, both the common and the civil law presumption is that a bilateral contract is being dealt with in the application of this principle. The principle does not make sense when dealing with unilateral contracts.

28. The term "condition precedent" is used in a different sense when dealing with a bilateral contract than when dealing with a unilateral contract. A condition precedent in a bilateral contract is an act that must occur before the duty of immediate performance under an existing contract arises. When concerned with the unilateral contract, however, an act must not only necessarily occur before the duty of immediate performance arises, but the condition precedent must occur before a contract is even formed. Therefore, "performance of the act is the acceptance of the offer." J. CALAMARI & J. PERILLO, *supra* note 27, § 138. This common law reasoning is valid for the civil law of Louisiana as well. See LA. CIV. CODE ANN. arts. 1761 (definition of a contract), 1765 (definition of unilateral and bilateral contracts), 2021 (definition of suspensive and resolutive conditions, analogous to conditions precedent and subsequent in the common law), & 2041 (retroactive effect of fulfillment of a suspensive condition) (West 1972).

In addition to disregarding the unilateral nature of the life insurance contract, the *Moseman* court also overlooked the fact that premiums were periodic, not installment, payments, *i.e.*, each additional payment resulted in a new unilateral contract. Thus, the insured did not purchase the insurance protection piecemeal, as in an installment sales contract; rather, he acquired the *whole* property right, albeit for a shorter discrete period of time.²⁹ Under this analysis, the proceeds in *Moseman* should have been the property of the community because it had paid the last premium and thus had created the unilateral contract in effect at the insured's death.³⁰

2. *Analogy to improvements on land*

A second reason advanced in support of the inception of title rule is that the use of community funds to pay life insurance premiums on a policy acquired before marriage is analogous to the use of community funds to make improvements on land that is the separate property of one spouse.³¹ Courts that adopt this reasoning find the property separate in character and allow a right of reimbursement to the community for the value of the funds it expends. This analogy is inappropriate to life insurance, however, because its property characteristics are significantly different from those of land or other forms of property to which this reasoning has been applied.³² Each periodic premium payment does not improve existing property as much as it creates a new right to future protection. In such circumstances, the property procured should acquire the ownership characteristics of the funds utilized for the purchase.³³ Thus, if community funds are used to pay the most recent premium on a life insurance policy, the com-

29. See note 80 and accompanying text *infra*.

30. If cash value existed, its apportionment between the competing estates, in addition to the characterization of the risk portion of the policy according to which estate paid the last premium, would have been the appropriate approach to the allocation of the proceeds. See Part III-B *infra*.

31. See, *e.g.*, *Rothman v. Rumbeck*, 54 Ariz. 443, 96 P.2d 755, 759 (1939); *DEFUNIAK & VAUGHN* § 79, at 190.

32. See Part I *supra*.

33. See *DEFUNIAK & VAUGHN* § 79, at 190-91, where the authors suggest that this principle should be followed in dealing with life insurance, rather than the inception of title (with reimbursement) principle. They suggest that application of the principle leads to the apportionment doctrine. See also Note, 42 TEXAS L. REV. 747, 751 (1964). The correct application of this rule, however, leads to application of the risk payment rule. See Part III-A *infra*.

munity purchases the policy's protection and the community should own the incidents of that protection.

3. *Uniformity*

Some courts, in addition to relying on *Moseman*, have maintained that uniformity with the state's rule regarding acquisition of realty militates for application of the inception of title rule to life insurance.³⁴ As was pointed out in the improvement of separate property analogy, this argument overlooks the significant differences between life insurance and other forms of property. The rights and obligations that arise upon a periodic premium payment do not parallel those which accrue when an installment payment is made on a land sales contract.³⁵ The uniformity reasoning thus substitutes a simplistic result for careful analysis.

4. *Equity*

Equity is another reason advanced for adoption of the inception of title rule.³⁶ Actually, however, the inception of title rule is particularly unfair to the noninsured spouse for a number of reasons. First, it does not fully account for the noninsured spouse's interest in the policy. When insurance is taken out before marriage, the inception of title rule recognizes the interest of the noninsured spouse as only one-half of the premiums paid from community funds. Thus, the protection element of the policy remains perpetually separate. Because of this unfairness, commentators have severely criticized the doctrine,³⁷ and

34. See *Berry v. Franklin State Bank & Trust Co.*, 186 La. 623, 173 So. 126, 131 (1937); *McCurdy v. McCurdy*, 372 S.W.2d 381, 383 (Tex. Civ. App. 1963).

35. See Part I *supra*.

36. In *McCurdy v. McCurdy*, 372 S.W.2d 381 (Tex. Civ. App. 1963), the court stated:

The inception of title rule is not less equitable in results [than the apportionment method]. While in this case the proceeds which would be proportionately attributable to the community under the tracing theory happened to exceed the community premium payments, in another case the gross premiums so paid out might well exceed the total proceeds. To permit the nature of the property to be determined by the monetary result is not necessarily equitable

Id. at 384. See Note, 42 TEXAS L. REV. 747, 750-51 (1964), for a discussion and criticism of this passage.

37. Note, *Community Property—Life Insurance—Application of the Inception of Title Doctrine*, 18 SW. L.J. 521, 525-27 (1964); Note, 42 TEXAS L. REV. 747, 750-52

one federal court in an inception of title jurisdiction has refused to follow it.³⁸ Even the Louisiana judiciary has begun to criticize the rule.³⁹ It also has been suggested that constructive fraud on the non-insured spouse may result when most of the premiums have been paid with community funds.⁴⁰

A second inequity may result where a separate policy's premiums have been paid largely with community funds and where the policy's cash value exceeds the total amount of the premiums paid.⁴¹ This excess of cash value over total premiums paid is profit to the taxpayer policyowner and is taxable as such.⁴² Under the inception of title rule,

(1964); Ray, *Life Insurance, Community Property & Death Taxes in Texas*, 26 TEXAS BAR J. 835, 896 (1963).

38. *Parson v. United States*, 308 F. Supp. 1159 (E.D. Tex. 1970). However, the Court of Appeals for the Fifth Circuit reversed despite its recognition of the inequities of the inception of title rule. *Parson v. United States*, 460 F.2d 228 (5th Cir. 1972). The appellate court reluctantly concluded:

We are not unmindful of the possible inequities which might arise from the slavish application of the "inception of title" rule of life insurance and other areas. Nevertheless, under *Erie* we cannot skirt the clear import of state decisional law solely because the result is harsh.

Id. at 234.

State courts also have refused to follow the inception of title rule. In states that have not accepted the apportionment rule for life insurance the inception of title rule has been held inapplicable for determining community and separate interests in retirement benefits. See *Lynch v. Lawrence*, 293 So. 2d 598 (La. App. 1974); *Ramsey v. Ramsey*, 96 Idaho 672, 535 P.2d 53 (1975); *Rister v. Rister*, 512 S.W.2d 72 (Tex. Civ. App. 1974). The following cases discuss the relation of the inception of title rule to pension benefits: *Mitchim v. Mitchim*, 509 S.W.2d 720, 725 (Tex. Civ. App. 1974); *Dessommes v. Dessommes*, 505 S.W.2d 673, 781 (Tex. Civ. App. 1973); *LeClert v. LeClert*, 80 N.M. 235, 453 P.2d 755, 756 (1969). It is not logical to continue to use one rule for life insurance and another for pension benefits because a portion of cash value life insurance is a cumulative asset (the cash value) analogous to retirement benefits.

39. See *Succession of Mendoza*, 288 So. 2d 673, 675-76 (La. App. 1973) (concurring opinion), which involved death benefits of an employer-provided plan which was analogous to insurance. A commentator on the case agreed with the concurring judge that the inception of title rule can be very unfair. LeVan, *Trusts, Survey—The Work of the Louisiana Appellate Courts for the 1973-1974 Term*, 35 LA. L. REV. 333, 339-40 (1975).

40. See Note, *Community Property—Life Insurance—Application of the Inception of Title Doctrine*, *supra* note 37, at 526. Constructive fraud—fraud on one spouse without the specific intent of the other spouse to defraud—is recognized both under the Spanish community property system and in the American community property jurisdictions. See DEFUNIAK & VAUGHN §§ 119, 123, 126. See also *Davis v. Prudential Ins. Co. of America*, 331 F.2d 346, 351-52 (5th Cir. 1964). See note 115 *infra*.

41. The cash value of a whole life policy taken out before age 35 will begin to exceed the total of the premiums paid at approximately age 60 to 65. See, e.g., BEST'S FLITCRAFT COMPEND 152, 155 (88th ed. A.M. Best Co. 1975).

42. This excess of cash value over the total of all premiums paid is the result of compound interest. The excess is taxable as ordinary income when the policy is sur-

this profit inures solely to the benefit of the separate estate.⁴³ In essence, then, the community not only has loaned money interest free to the separate estate,⁴⁴ but it has been deprived of valuable investment capital. It should be noted that the dollars with which the community is reimbursed will have lost much of their original value because of inflation.⁴⁵ Thus, the equities of this situation do not support the inception of title rule.

rendered and is considered profit to the policyowner. INT. REV. CODE OF 1954, § 72 (e); Treas. Reg. § 1.72-11(d), T.D. 6885, 1966-2 CUM. BULL. 307.

43. Under the inception of title rule this profit is considered to be the separate property of the policyowner spouse; the community is entitled only to reimbursement of premiums paid. However, Louisiana and Texas statutes state that the profit of separate property must be community property. LA. CIV. CODE ANN. arts. 2386, 2402 (West 1972); TEX. FAM. CODE ANN. § 5.01 (1975). Therefore, the application of the inception of title rule conflicts with the statutory scheme in those states. Idaho also provides that the profit of separate property must be community property. IDAHO CODE § 32-906 (1963). However, the Idaho Supreme Court has not had occasion to adopt a rule. See note 5 *supra*.

An example is illustrative. The figures utilized are derived from BEST'S FLITCRAFT COMPEND, *supra* note 41, at 152, 155. Assume that a single male age 25 purchases a \$10,000 non-participating (non-dividend paying) whole life insurance policy and pays the initial premium of \$132.50. He subsequently marries and pays 39 subsequent premiums with community funds. If the insured surrenders the policy at age 65, its cash value would be \$5,730. With this amount, he could reimburse the community \$5,167.50 for the 39 premiums it paid (of this amount one-half represents the wife's share) and realize \$430 profit for himself as his separate property. Thus, the profit equals cash value received less the cost of reimbursement to the community and to the separate estates for premiums paid. This result violates the Texas and Louisiana statutes.

Even if the person in this example did not cash in his policy at age 65, but he instead died at that age, application of the inception of title rule would still violate the Texas and Louisiana statutes because his estate would realize separate profit. If his estate received the \$10,000 face value, the proceeds would represent: (1) cash value equal to the total of all premiums paid (\$5,300); (2) a profit or excess of cash value over the total of premiums paid (\$430); and (3) a risk or protection element (\$4,270). See note 120 *infra*. If he reimburses the community for premiums it paid (\$5,167.50), then his separate estate would still receive: (1) reimbursement for the separate premium paid (\$132.50); (2) the profit or excess of cash value over the total premiums paid (\$430); and (3) all the risk element proceeds (\$4,270). Inflation aggravates this inequity.

There are no practical differences between saving one's money in a bank and saving it in a cash value policy that are significant enough to justify their being treated so differently. In neither is one compelled to deposit; in both one is taxed only upon the income or profit, in both one can withdraw his money at any time, and in both the sum is considered as an asset of the owner-depositor.

44. Lost interest can be significant. Using the fact pattern in note 43 *supra*, the community is entitled to a reimbursement of \$5,167.50 for the premiums paid. If the community had, instead, invested the \$132.50 each year for 39 years and received an after-tax return of a conservative 4% per year compounded annually, it would have accumulated \$12,458.45—over twice as much. Thus, the community is deprived of \$7,290.95.

45. From 1800 to 1940 the cost of living in the United States, as measured by the consumer price index, was relatively stable. Therefore, when the inception of

5. *Simplicity*

The inception of title rule has been upheld in part because of its simplicity of application.⁴⁶ All the court need do is determine whether the first premium was paid with separate funds. Although the rule is simple, neither of its alternatives is complex, and the benefits of simplicity should not outweigh the ill effects of an unsound logical basis and the inequity of the inception of title approach.

6. *Life-long contract*

Some commentators have argued that the life insurance contract constitutes a single life-long contract rather than a series of yearly renewable contracts.⁴⁷ If this contention is accurate, the inception of title rule would seem to be sound. Arguments advanced to substantiate the continuous contract view, however, do not survive analysis. The first of these arguments is that the level premium of a whole life policy during the insured's life indicates the existence of one continuous life-long contract.⁴⁸ Advocates of this reasoning contend that "[t]he risk [of death] becomes greater with advanced age but the premium remains constant indicating it bears no relation to the year it was paid."⁴⁹ This statement is incorrect. The risk of one's death increases yearly. The insurance company can recognize this increased risk either by charging more per year (as it does in one-year renewable term

title doctrine was formulated in 1886, inflation was not a common problem. Since 1940, however, the cost of living has quadrupled. See Table 122, *The Consumer Price Index, 1800-1974*, in U.S. BUREAU OF LABOR STATISTICS, DEP'T OF LABOR, HANDBOOK OF LABOR STATISTICS 313 (reference ed. 1975); Wall St. J., Jan. 22, 1976, at 1, col. 4. Assuming that inflation continues to be a problem, courts should consider interest and inflation factors when applying rules of law first set down 100 years ago during times of stable price levels. See Bartke, *Yours, Mine and Ours—Separate and Community Funds*, 44 WASH. L. REV. 379, 389-90, 419 (1969).

46. See, e.g., *McCurdy v. McCurdy*, 372 S.W.2d 381 (Tex. Civ. App. 1963).

47. W. VANCE, HANDBOOK ON THE LAW OF INSURANCE § 49, at 297-99 (3d ed. 1951); Catlett, *Status of the Proceeds of Life Insurance Under the Community Property System*, 5 WASH. L. REV. 45, 47 (1930); Mulligan, *Does War Excuse the Payment of Life Insurance Premiums?* 17 FORDHAM L. REV. 63, 74 (1948); Comment, *Life Insurance Proceeds as Community Property*, 13 WASH. L. REV. 321, 324 (1938).

48. W. VANCE, *supra* note 47, at 298-99; Catlett, *supra* note 47, at 47; Mulligan, *supra* note 47, at 74; Comment, *supra* note 47, at 324-25.

49. Mulligan, *supra* note 47, at 74. This level premium aspect of whole life insurance contrasts with term policy premiums which increase at the expiration of each term, reflecting an enhanced risk of death because of increased age during the subsequent period.

insurance) or by decreasing the amount of protection it affords (as it does in decreasing term insurance). In cash value insurance the amount of pure protection decreases each year as the cash value increases.⁵⁰ This is a result of the annual increase in the cost of protection.⁵¹

Another argument advanced in support of the continuous contract theory is that a whole life policy is intended to cover the insured for the duration of his life.⁵² This is also incorrect. Persons presently 96 years of age or older⁵³ who have throughout their lives paid whole life premiums are now without insurance protection because their policies have matured.⁵⁴ Therefore, they did not in fact purchase a continuous life-long contract of insurance but one which was annually renewable⁵⁵ until age 96.

Other arguments supporting the continuous contract theory likewise lack merit. Under a view that was once widely held, a premium payment was treated as a condition subsequent under a continuous

50. See note 15 *supra*.

51. One commentator indicates:

One [implication of the view that cash value insurance can be considered as separable into a term insurance element and a savings element] is the fact that such an approach will show . . . that the yearly price per \$1000 of protection has a tendency to rise as the attained age of the policyholder increases, even in level-premium policies.

J. BELTH, THE RETAIL PRICE STRUCTURE IN AMERICAN LIFE INSURANCE 34-35 (1966). See also Belth, *Life Insurance Price Measurement*, 57 Ky. L.J. 687, 690-92 (1969); Belth, *Price Disclosure in Life Insurance*, 1972 Wis. L. Rev. 1054, 1063. It is also interesting to note that the cost per \$1,000 of the protection element of whole life insurance is not necessarily less than that of term insurance. J. BELTH, THE RETAIL PRICE STRUCTURE IN AMERICAN LIFE INSURANCE 104-09 (1966). For the method of calculating the cost of the protection element for any given year, see *id.* at 35-38. J. BELTH, LIFE INSURANCE: A CONSUMERS' HANDBOOK 35-36, 234 (1973), and two articles by the same author, 57 Ky. L.J. 687, 689-90 (1969); 1972 Wis. L. Rev. 1054, 1064-66.

52. See Mulligan, *supra* note 47, at 74.

53. Over 78,000 people in the United States were age 95 or over in 1970. U.S. BUREAU OF THE CENSUS, CENSUS OF POPULATION: 1970, 1 CHARACTERISTICS OF THE POPULATION, Pt. 1, UNITED STATES SUMMARY, § 1, at 265, Appendix B, at A-14. No figures are available for those age 96 and over.

54. When a policy matures, its cash value equals its face value. Thus, there is no protection element of the policy remaining after maturity. The age at which a policy matures is determined by mortality tables. Policies issued before 1947 were based on a mortality table on which the maximum age was 95. Policies today are written on a table of mortality in which the maximum age is 99. See J. MACLEAN, *supra* note 10, at 71-76; LIFE INSURANCE FACT BOOK at 104-05. Therefore, today's whole life policies will mature when the insured reaches age 100. There are still a number of people, however, that live beyond age 100. The 1970 census estimated the number of persons age 100 and over to be 5,000. U.S. BUREAU OF THE CENSUS, *supra* note 53.

55. See note 131 and accompanying text *infra*.

life-long contract.⁵⁶ More recently, authorities have come to recognize that a premium is a condition precedent to the formation of a unilateral insurance contract.⁵⁷ It also has been observed that the existence of some rights, such as dividends and cash value, date from the time of the first premium payment.⁵⁸ Although this observation is correct, it is no more profound than acknowledging that one's right to a bank savings deposit and the interest thereon is dependent on the length of time the deposit has been in the bank. The crucial distinction missed by supporters of the continuous contract theory is that the promise of the life insurance contract for *protection* dates only from the *most recent* premium payment.⁵⁹

B. *The Apportionment Rule and Its Application to Life Insurance*

Under both the Spanish and the American community property systems, all that is earned or acquired during marriage is presumed to be property of the community, shared equally by each spouse.⁶⁰ In both Spain and the United States community property jurisdictions, property owned before marriage remains the separate property of each spouse after marriage.⁶¹ If a spouse sells his or her separate property during coverture and uses the proceeds of the sale to make other acquisitions, the acquired property is also separate.⁶² "Separate property continues to be separate through changes and transitions, so long as it

56. A condition subsequent has been defined as "any fact the existence or occurrence of which, by agreement of the parties, operates to discharge a duty of performance after it has become absolute." J. CALAMARI & J. PERILLO, *supra* note 27, at 227-29. See W. VANCE, *supra* note 47, at 297-98; Comment, *supra* note 47, at 324-25; *New York Life Ins. Co. v. Statham*, 93 U.S. 24, 30 (1876). See also J. APPLEMAN, *supra* note 15, § 8071, and cases cited therein; 6 G. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 31.12, at 14-16 (2d ed. 1961), and cases cited therein.

57. See notes 23 & 28 and accompanying text *supra*. See also *Bankers Nat'l Life Ins. Co. v. Cooper*, 111 N.J. Super. 264, 268 A.2d 78, 83 (1970).

58. Comment, *supra* note 47, at 324.

59. It must be emphasized that an insured does not renew \$10,000 worth of protection each year on a cash value policy with a face value of \$10,000. In fact, he only renews \$10,000 less the cash value; if the annual premium is not paid he remains entitled to the cash value whether or not he dies. Thus, the cash value exists independent of future premium payments. Payment of the premium entitles one to (1) a small increase in cash value and (2) the amount of actual insurance *protection* for the coming year, which is the difference between the face value and cash value of the policy. See note 15 *supra*.

60. See DEFUNIAK & VAUGHN § 66.

61. *Id.* § 77.

62. *Id.*

can be clearly traced and identified.”⁶³ This principle is known as the source doctrine and is used to overcome the presumption that an asset acquired during marriage is community property.⁶⁴

The apportionment doctrine is an extension of the source doctrine. Under this doctrine when property is acquired partially with community funds and partially with separate funds, the asset is both community and separate property in proportion to the amount contributed from each fund.⁶⁵ Arizona, California, Idaho and Washington follow the apportionment doctrine in varying degrees.⁶⁶

1. *Analogy to other types of property*

The apportionment rule has been applied to life insurance policies in California and Washington. Courts of both states have relied upon their previous use of the apportionment rule in cases involving tangible property to justify its application to life insurance policies in which premiums had been paid with both community and separate funds.

The problem of the ownership of life insurance proceeds in such circumstances was first considered by a California probate court in *Estate of Webb*⁶⁷ in 1875. In *Webb* one annual premium on an endowment policy⁶⁸ had been paid from the insured's separate funds before marriage and two annual premiums had been paid from com-

63. *In re Brown's Estate*, 124 Wash. 273, 276, 214 P. 10, 11 (1903). See also DEFUNIAK & VAUGHN § 77.

64. Cross, *supra* note 19, at 767.

65. Such apportionment may have occurred under the Spanish system, for it was used in other earlier European community property systems. DEFUNIAK & VAUGHN at 184 n.27 and accompanying text. In United States community property jurisdictions, such separation into community and separate proportions is not uniformly favored. *Id.* § 64, at 133-34; § 68.2, at 152; § 77, at 185. The apportionment doctrine is especially favored if acquisition is initiated before marriage and completed during marriage, *id.* § 64, at 133-34, or initiated during marriage and completed after its termination. *Id.* § 68.2, at 152.

66. *Id.* at 133-34, 152.

67. Myr. Prob. 93 (Cal. 1875). The complete text of the court's analysis is as follows:

The consideration upon which the insurance company promised to pay the policy, was the payment of the yearly premiums. Those premiums were paid, one-third out of the separate property and two-thirds out of the common property. It legitimately follows that the proceeds of the policy belong to the respective funds from which the payments were made, viz: one-third to the separate property, and two-thirds to the common property.

68. An endowment policy is a variety of cash value insurance. See note 14 *supra*.

munity funds after marriage. The designated beneficiary was the insured's estate. Upon his death, the court divided the proceeds of the policy, finding one-third to be separate property and two-thirds community property. The court reasoned that because the consideration for the policy was the payment of premiums from both separate and community funds, the ownership of the policy and, therefore, the policy's proceeds, should reflect the sources of the consideration. This reasoning is based upon the principle that separate and community estates share ownership in property pro rata according to the respective proportions of the total consideration paid by each estate.⁶⁹ Subsequently in *Modern Woodmen of America v. Gray*,⁷⁰ a California court of appeals applied the apportionment doctrine to life insurance, basing its holding in part upon *Vieux v. Vieux*,⁷¹ in which the doctrine was held applicable to realty purchased with both separate and community funds.

In Washington application of the apportionment doctrine to life insurance evolved in several discrete steps. Initially, the Washington Supreme Court applied the doctrine to tangible property.⁷² Subsequently, the court held that life insurance proceeds were property.⁷³ In 1938 the court in *In re Coffey's Estate*⁷⁴ appeared to conclude that the apportionment doctrine applied to life insurance. The sole issue in *Coffey's Estate* however, was the extent to which the insurance proceeds were subject to the inheritance tax, and the court's analysis of the apportionment rule in the insurance context consisted of a single sentence of questionable authority.⁷⁵ Nevertheless, the Washington

69. See DEFUNIAK & VAUGHN § 64, at 133-34.

70. 113 Cal. App. 729, 299 P. 754 (1931). This case has been followed and cited by the California appellate courts but never has been accepted explicitly by the California Supreme Court. See, e.g., *Polk v. Polk*, 228 Cal. App. 2d 763, 39 Cal. Rptr. 824 (1964); *Gettman v. City of Los Angeles*, 87 Cal. App. 2d 862, 197 P.2d 817 (1948); *McBride v. McBride*, 11 Cal. App. 2d 521, 54 P.2d 480 (1936).

71. 80 Cal. App. 222, 251 P. 640 (1926).

72. See, e.g., *Jacobs v. Hoitt*, 119 Wash. 283, 287, 205 P. 414, 416 (1922). See generally Cross, *supra* note 19, at 748.

73. See *Occidental Life Ins. Co. v. Powers*, 192 Wash. 475, 74 P.2d 27 (1937), in which the court held that a policy paid for with community funds gave the wife a vested interest in its proceeds because such proceeds constitute property.

74. 195 Wash. 379, 81 P.2d 283 (1938).

75. The *Coffey* court concluded that Washington's former application of the source doctrine to tangible property provided a reason to apply such an approach to life insurance. The court's analysis of the issue, in its entirety, was that "[t]he separate character of the property continues so long as it can be clearly traced and identified." *Id.* at 385, 81 P.2d at 286. Not only was there no analysis of the applicability

Supreme Court expressly adopted the apportionment rule for life insurance nine years later in *Small v. Bartyzel*.⁷⁶ In *Small* premiums on a group term policy had been paid with separate funds before marriage and with community funds thereafter. On the insured's death, claimants under each estate sought the proceeds. In concluding that the proceeds should be apportioned, the court reasoned that the wife had obtained a vested property interest in the policy through the expenditure of community funds for premiums. Therefore, the court rejected the inception of title rule and held that the wife was entitled to claim her proportionate share of the proceeds.⁷⁷ This holding also implicitly assumed that the separate estate obtained a vested interest in the proceeds by reason of its premium payments.⁷⁸ Thus, in applying the apportionment rule the court treated life insurance as it had treated tangible property.⁷⁹

of the source doctrine to life insurance, but the court cited the wrong case as authority for the doctrine. The case cited, *Schramm v. Steele*, 97 Wash. 309, 166 P. 634 (1917), involved the wife's vested interest in community property; the court held that community property cannot be subjected to execution to satisfy a separate judgment against the husband for his personal torts. The case which the *Coffey* court intended to use as authority for the source doctrine was *In re Brown's Estate*, 124 Wash. 273, 214 P. 10 (1923). This is evident from the discussion of the apportionment doctrine in respondent's brief. Brief for Respondent at 28-30. *In re Coffey's Estate*, 195 Wash. 379, 81 P.2d 283 (1938). In addition, virtually the same sentence quoted by the court in *Coffey* is found in *Brown's Estate*, but not in *Schramm*. 124 Wash. at 276, 214 P. at 11.

76. 27 Wn. 2d 176, 177 P.2d 391 (1947).

77. The court relied on *Occidental Life Ins. Co. v. Powers*, 192 Wash. 475, 74 P.2d 27 (1937), for two propositions: (1) the payment of premiums from community funds gives the community a vested interest in the policy proceeds; and (2) a beneficiary designation under the portion of the policy paid from community funds is void without consent of the wife.

78. This assumes the presumption that the policy is completely community property could be overcome. See text accompanying note 60 *supra*. The presumption is overcome by proving the number of premiums paid by the separate estate prior to marriage. For a discussion of the community property presumption and means to overcome it, see DEFUNIAK & VAUGHN §§ 60-61.

79. An idiosyncrasy of the apportionment rule as applied to life insurance warrants mention. Under this doctrine, previously accumulated interests in a group term policy can be cut off if the insured's employer replaces master policies. For example, if an employee pays 10 premiums with separate funds, marries and pays 10 additional premiums before death, the apportionment rule would characterize the proceeds as one-half community and one-half separate. If, however, his employer had changed policies after five of the initial separate payments, two-thirds of the proceeds would be allocated to the community. This change of master policies occurred in *Small* even though the subsequent master policy involved the same insurance company and there was no lapse of protection. 27 Wn. 2d at 178, 177 P.2d at 392. The court, however, did not discuss the resultant changed characterization of ownership. Evidently both separate and community estates can be divested of interests in a policy by factors completely beyond the parties' control, even though the insured is continuous-

As the rule has evolved in California and Washington, it has been misapplied to life insurance because the courts have failed to consider that each annual premium pays for both a permanent cumulative asset and a temporary noncumulative asset. Because only the cash value is a cumulative asset, it alone can be apportioned according to the contributions of the separate and community estates. In contrast, the temporary noncumulative asset purchased by the policyowner is protection against the risk of death.⁸⁰ The portion of each premium attributable to the purchase of protection is generally not capable of apportionment.⁸¹

2. *The right to keep the insurance policy in force*

In a frequently-cited case, *Modern Woodmen of America v. Gray*,⁸² a California appellate court argued that the apportionment doctrine reflected the value of the right of the insured to keep his insurance policy in effect past the time when he could not obtain a new policy from the same company. The court stated:⁸³

[I]t was only by virtue of his having obtained the certificate of insurance prior to his marriage and his having regularly paid the premiums thereon in the meantime that he was entitled to continue to enjoy the protection afforded by the certificate. . . . [H]e had acquired the right to have the contract of insurance continued in force by virtue of the payment of premiums from its issuance to him in 1898 until the date of his second marriage in 1923. This was a valuable right in the eyes of the law

Thus the court felt that the apportionment doctrine fairly compensated the separate estate for the "valuable right" of being able to keep the policy in force.

ly protected and, in fact, is unaware that the employer has changed master policies. The employer has complete control over such "vested" interests of the respective estates.

80. Thus, a life insurance contract is not analogous to an installment contract for the purchase of tangible property. A life insurance premium buys the whole of a product (insurance protection) for a limited period of time, whereas a payment on an installment contract buys a fractional interest in a product for an essentially unlimited period of time. See text accompanying note 29 *supra*.

81. The risk portion may be apportioned if the last payment was composed of traceable percentages of both separate and community funds. See note 122 and accompanying text *infra*.

82. 113 Cal. App. 729, 299 P. 754 (1931).

83. 299 P. at 755.

The court's argument fails for several reasons. First, the apportionment doctrine is based upon the assumption that uninsurability occurs during the period the prior estate paid premiums because it awards that estate a sum of money for the insurability right. However, it is more common that as a person grows older, the likelihood of uninsurability increases accordingly. Thus, the insured spouse more likely will become uninsurable during the period when the subsequent estate is paying premiums than when the previous estate was paying premiums.⁸⁴ Second, the apportionment rule rests on the assumption that life

84. The following example illustrates the analytical flaws of the *Gray* decision. Assume that a man acquired a \$10,000 life insurance policy while single, paid seven annual premiums prior to marriage, and paid the final three annual premiums after marriage with community funds before he died. Three further situations can be posited: (1) the man became uninsurable one year after purchasing the policy; (2) the man did not become uninsurable before he died; or (3) the man became uninsurable after marriage and before death.

In the first situation, under the apportionment rule, \$7,000 of the proceeds are characterized as the husband's separate property and \$3,000 are characterized as community property, of which \$1,500 may be controlled by the husband. In California the husband could dispose of his half interest in the community portion of the life insurance policy through beneficiary designation. *New York Life Ins. Co. v. Bank of Italy*, 60 Cal. App. 602, 214 P. 61 (1923). A husband in Washington, the other state that has adopted the apportionment theory, could dispose of his half interest in the community life insurance policy to a beneficiary other than his wife, without her consent, only if his estate were the beneficiary. *In re Towey's Estate*, 22 Wn. 2d 212, 155 P.2d 273 (1945). Therefore, when the husband died the wife could get only \$1,500 of the \$10,000 policy, even though the community was paying for the protection at the time of his death. The proponents of the apportionment rule view the existence of the right of insurability as justification for the husband's control of up to \$8,500 of the proceeds.

In the second situation, the husband's continued insurability renders the right to continued insurance (subsequent to becoming uninsurable) worthless as he could have dropped the present policy at any time and passed a physical examination for another policy. Although no valuable right of insurability was brought into the marriage, the separate estate is compensated under the apportionment rule as if there were such a right. The community estate is, according to the aforementioned justification, paying the separate estate for rights the community could have as easily acquired.

In the third situation, if either estate should be compensated for the right of insurability, it should be the community estate as it kept the policy alive immediately after the husband became uninsurable. Nevertheless, the apportionment rule would characterize \$7,000 as separate property and \$3,000 as community property. See note 108 and accompanying text *infra*.

It may be argued that the contractual right to keep an insurance policy in force is still valuable to the insured at the time of marriage even if no uninsurability is involved. This argument rests on the rationale that the insured gains a valuable right if he takes out a policy early in his life, for he has the "right" to keep his insurance in force for lower premiums than a person who buys the same policy years later. If one begins coverage at age 25 rather than age 35, premiums indeed may be lower, but the insured will have paid for the policy ten years longer than a person starting at age 35. Whether one pays less per payment over a longer period of time or more per payment over a shorter period of time is solely a matter of personal preference. Starting an insurance plan at a younger age means only that "the company intends

insurance cannot be obtained at the regular rate by one who is uninsurable. This is not always true. Most group and credit⁸⁵ life insurance plans do not require evidence of insurability for participation.⁸⁶ Finally, it is clear that the apportionment doctrine does not result in a constant valuation of the insurability right. Under the apportionment rule, the insurability right actually decreases in value annually,⁸⁷

to collect a lower premium over a longer period of time." G. REYNOLDS, *supra* note 15, at 111. See also J. BELTH, *LIFE INSURANCE: A CONSUMERS' HANDBOOK* 17 (1972); N. DACEY, *WHAT'S WRONG WITH YOUR LIFE INSURANCE* 200-01 (1963).

Insurance may actually be cheaper when bought later in life because those who buy it later have saved the cost of the earlier years of protection. This saving may easily offset the higher premium rates of a policy beginning at a later date. For example, imagine a pair of twins, A and B. Assume A took out a \$10,000 whole life policy at age 25 and B took out the same type policy at age 35. If it is assumed that B deposited in his bank savings account at least the same amount per year that A paid in policy premiums and that B received a conservative 4% after-tax compound interest rate, B's savings would total more than \$1,600 by age 35. Four percent annual interest on this sum more than offsets the increase in premium cost over the preceding ten years. In addition, at age 35, B will have bank savings twice as large as A will have in cash value, and if B dies, his heirs would not only receive \$10,000 from the insurance company, but would get his bank account as well. This example will work to B's benefit with an after-tax interest rate of as low as 3.5%. For premium and cash value figures, see BEST'S *FLITCRAFT COMPEND*, *supra* note 41, at 152,155.

The purpose of this example has been to show that because B has had the use of his money for ten more years than A, B has benefited to a greater extent than he subsequently has been forced to pay in higher insurance costs. There may have been other ways in which B could have used his money during the ten years and received benefits which would have outweighed the detriment of the increased cost of insurance at age 35. If the insured is insurable at the later date, he or she is no better off (and may be worse off) starting an insurance program at a younger age. Therefore, the prior estate should not be compensated for a fanciful "right of low premium payments." If the insured was uninsurable before marriage, or the courts wish to value the right of insurability regardless of individual insurability, the value of this right can be calculated in a more precise manner than the apportionment rule allows. See note 114 *infra*.

85. Credit life is term insurance issued through a lender to cover payment of a loan or other obligations in case of death. *LIFE INSURANCE FACT BOOK* at 115.

86. It has been observed:

Employees who are otherwise uninsurable may be covered under a group contract because the group is underwritten (i.e., its insurability is judged and the terms of the contract, including rates, fixed) as a unit.

The insurer is concerned with average results for the group and can accept the poorer-than-average individual risk if the group as a whole is acceptable.

A. MOWBRAY, R. BLANCHARD, & C. WILLIAMS, JR., *supra* note 15, at 350. See J. APPLEMAN, *supra* note 15, § 44, at 60; J. BELTH, *LIFE INSURANCE: A CONSUMER'S HANDBOOK* 90 (1973); 19 G. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 82:11 (2d ed. 1968); Gregg, *Fundamental Characteristics of Group Insurance*, in *LIFE AND HEALTH INSURANCE HANDBOOK* 351, 352 (3d ed. D. Gregg & V. Lucas 1973); Williams, *Group Life Insurance*, in *id.* 372, 377. See also note 108 *infra*. Group life and credit life account for over 47% of the total face amount of insurance in force in the United States. *LIFE INSURANCE FACT BOOK* at 22.

87. In the ten-year example used in note 84 *supra*, the insurability right was worth 7/7 of the policy proceeds (\$10,000) before the marriage, 7/8 (\$8,750) after one year of marriage, 7/9 (\$7,778) after two years, and 7/10 (\$7,000) after three years.

whereas it would seem that the insurability right should at least remain constant, if not increase, as time passes.

3. *Influence of federal estate tax treasury regulations*

A prior treasury regulation⁸⁸ provided a justification for use of the apportionment rule. The United States Supreme Court in *Lang v. Commissioner*⁸⁹ applied the apportionment rule to allocate the proceeds of a Washington couple's life insurance policy for federal estate tax purposes. The Court concluded that the treasury regulation mandated its application. Subsequently, in *In re Coffey's Estate*⁹⁰ the Washington Supreme Court followed *Lang*. However, the court did not discuss the appropriateness of applying a federal estate tax rule to state community property questions of life insurance policy ownership between spouses.⁹¹ Interestingly, the federal apportionment rule was later abandoned by the federal government because Congress deemed it to be unfair.⁹²

III. A PROPOSED RULE: THE RISK PAYMENT DOCTRINE

A. *The Risk Payment Doctrine and Term Insurance*

Under the risk payment doctrine, the source of funds (*i.e.*, commu-

88. Treas. Reg. 70, T.D. 3918, 28 TREAS. DEC. INT. REV. 427, 456-58 (1926), quoted in *Lang v. Commissioner*, 304 U.S. 264, 269 (1938), read, in part, as follows: [Art. 25] Where a portion of the premiums were paid by the beneficiary and the remaining portion by the decedent the insurance will be deemed to have been taken out by the latter in the proportion that the premiums paid by him bear to the total of premiums paid.

[Art. 28] [W]here the proceeds [of the policy are payable to a beneficiary other than the decedent's estate] and only a portion of the premiums were paid by the decedent, the amount to be listed on [Schedule C of the return] is that proportion of the insurance receivable which the premiums paid by the decedent bears to the total premiums paid.

89. 304 U.S. 264 (1938).

90. 195 Wash. 379, 81 P.2d 283 (1938). See text accompanying notes 74-75 *supra*.

91. This deficiency was criticized immediately after the *Coffey* decision. See Comment, *supra* note 47, at 324.

92. See S. REP. NO. 1622, 83d Cong., 2d Sess. 124 (1954), quoted in 2 J. MERTENS, THE LAW OF FEDERAL GIFT AND ESTATE TAXATION § 17.01 n.1 (1959); 7 J. RABKIN & M. JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION § 2042, at 3216-17 (1963). Congress has subsequently refused to reinstate the rule. H.R. REP. NO. 8381, 85th Cong., 1st Sess. § 56 (1957). See also Brown & Sherman, *Transfers in Contemplation of Death*, 101 TRUSTS & ESTATES 790, 844 (1962).

nity or separate) paying for protection at the time of the insured's death determines the characterization of the proceeds of a term policy as community or separate property. An example illustrates the impact of this proposed rule. Assume that a person age 25 took out a \$10,000 term policy while single, paid premiums on the policy for seven years with separate funds, married, paid premiums for three years with community funds, and then died. Under the risk payment doctrine, the proceeds of the policy would be characterized as community because the community paid for the insurance protection existing when the insured died. Application of the risk payment doctrine, therefore, would create an interest in the noninsured spouse of \$5,000,⁹³ or one-half of the community property. In contrast, the apportionment doctrine would limit the interest of the noninsured spouse to \$1,500,⁹⁴ and the inception of title doctrine would provide only \$90 (one-half of the last three premiums).⁹⁵

The risk payment doctrine has several advantages over the inception of title and apportionment rules. First, it treats life insurance as a unique type of property. As suggested above,⁹⁶ life insurance should be regarded as property which is repurchased yearly and which cannot cumulate interest except for its cash value. The ownership characteristics of term life insurance differ from those of other types of property. One author, speaking in the context of group term policies, stated:⁹⁷

93. This means that regardless of the beneficiary designation on the policy, the noninsured spouse has an absolute right to \$5000, one-half of the proceeds. Of course, under all three rules the insured spouse may validly designate the noninsured spouse to receive a portion or all of the insured spouse's interest in the proceeds, in addition to the noninsured spouse's interest.

94. This is the correct figure under California law whether the insured made his estate or a third party (other than his spouse) the beneficiary. In Washington, this figure is correct only if the beneficiary is the insured's estate. If the beneficiary is a third person (other than the noninsured spouse), the figure would be \$3000. See note 84 *supra*.

95. The total premiums paid for three years on the individual \$10,000 nonparticipating five-year renewable and convertible term policy contemplated in this example range from less than \$130 to more than \$200, depending upon the company from which the insurance is purchased. See *A Guide to Life Insurance: Pt. 1*, 39 CONSUMER REPORTS 35, 49-50 (1974). In order to comprehend the impact of acceptance of the risk payment doctrine and its application to term insurance, it should be noted that almost 63% of the total amount of insurance in force in the United States is term insurance. Group term alone accounts for over 41% of the insurance in force. These percentages are continuing to increase annually. LIFE INSURANCE FACT BOOK at 22, 24-25.

96. See Part I *supra*.

97. D. GREGG, GROUP LIFE INSURANCE 83 (3d ed. 1962) (emphasis added). An-

An employee who terminates has *had* the benefit of the protection and has no further equity in the plan to be accounted for or to be administered. . . . [T]he plan can easily be changed or terminated by the employer and the insurance company if necessary, since there are *no vested interests* to be disturbed.

Term life insurance, then, is an aleatory contract, providing the insured with protection for a specified period but creating no vested property rights in the traditional sense.⁹⁸ The risk payment doctrine incorporates this concept.

The risk payment doctrine correctly treats term insurance as a series of unilateral contracts, rather than as one bilateral contract. As previously indicated, each premium payment is both the condition precedent to and the consideration necessary for the insurance company's promise to pay a benefit upon the death of the insured.

The risk payment doctrine also treats life insurance in a manner consistent with community property principles. The analogy of life insurance to community funded improvements on separately owned land is not appropriate. When dealing with life insurance, the better community property analysis would require newly acquired property to assume the same character as the property used for its acquisition. Because life insurance protection is reacquired annually, each year's protection should be characterized in accordance with the fund used to pay that year's premium.

Several state courts have recognized the unique nature of term insurance⁹⁹ and the applicability of the risk payment doctrine to it. Ari-

other author noted:

Most of the group life insurance in force is on the 1-year renewable-term plan. This plan is the most popular because it is simple and its cost is low. It is well adapted to the insurance of employees who form a fluctuating group, since adjustments of premiums on account of new entrants and withdrawals are easily made and there are *no accumulated equities* to be adjusted.

J. MACLEAN, *supra* note 10, at 381 (emphasis added).

98. Thus, one author's description of a group disability policy also applies to term life insurance. "Such protection is peculiarly designed to meet future needs, is essentially 'instantaneously' available by reason of current employment and not acquired over a time span." Cross, *supra* note 19, at 758-59 n.135.

99. Concerning an individual term policy, one court seemed to accept the following contention as true:

[T]he chief difficulty with its [annual renewable term] policy from the company's standpoint is that, there being no cash value built up, the policyholder has nothing to lose by permitting the policy to lapse and buying a similar policy elsewhere, and such lapses are encouraged by agents who are interested in earning additional first-year premiums.

Survivors Benefit Ins. Co. v. Farmer, 514 S.W.2d 565, 567 (Mo. 1974).

zona appellate courts have explicitly adopted it for term insurance policies,¹⁰⁰ although the rule for cash value policies remains the inception of title doctrine.¹⁰¹ One of these courts remarked: "[t]he fact that the husband's separate estate paid a premium for a risk long since expired without loss should not give his separate estate any vested interest in the proceeds."¹⁰² The Texas Supreme Court has also invoked the doctrine.¹⁰³ In *Small v. Bartyzel*,¹⁰⁴ in which Washington adopted

100. *Gaethje v. Gaethje*, 7 Ariz. App. 544, 441 P.2d 579 (1968); *Lock v. Lock*, 8 Ariz. App. 138, 444 P.2d 163 (1968). In *Gaethje* the husband acquired a group term life insurance policy in 1947 during his second marriage, the premiums for which presumably were paid monthly. In 1952 he divorced his second wife and remarried her in 1953. He died while married and covered by the policy in 1966. The designated beneficiary was a son by a former marriage. The court held that the proceeds of the policy were all community property despite the fact that some payments were made on the policy while he was single. This conclusion was reached because the community was paying for the risk under which the insured died. Furthermore, the court held that the wife was the victim of constructive fraud by the husband's designation (without the wife's consent) of the son as beneficiary to the extent that she did not receive one-half the value of the community property (including life insurance proceeds) at his death. In *Lock* the husband and his first wife were divorced in 1961. In 1962 he changed the beneficiary of his group term policy, which had been in effect continuously since before his divorce, to his second wife. He died in 1963. The first wife then claimed, *inter alia*, that because the policy had once been community property, upon divorce it was owned by the former spouses as tenants in common and that the former husband could not designate a third person as beneficiary without her consent. The court, quoting *Gaethje*, held that the community had paid for a risk long since expired without loss and that the husband's post-divorce funds "paid for all of the coverage that resulted at the time of Mr. Lock's death." 444 P.2d at 170.

101. See *Rothman v. Rumbeck*, 54 Ariz. 443, 96 P.2d 755 (1939). See also *Everson v. Everson*, 24 Ariz. App. 239, 537 P.2d 624, 628-29 (1975), in which the court said that because the husband had paid premiums on a cash value policy before marriage, the trial court's designation of the policy as community property was erroneous.

102. *Gaethje*, 441 P.2d at 585.

103. In *Sherman v. Roe*, 153 Tex. 1, 262 S.W.2d 393 (1953), the husband was issued a certificate of insurance under his employer's master group accidental death policy. The husband paid premiums on his insurance for approximately six and one-half years before marriage and four and one-half years after marriage. After three years of marriage the face amount of the policy was increased from \$2,000 to \$9,000. At the time that the couple was simultaneously killed in an aircraft accident, the wife was the beneficiary under the policy. The court ruled that the proceeds were community property:

Whatever rights to the proceeds of the insurance might accrue to [the husband] as his separate property on account of his having procured the insurance for \$2,000 before his marriage to [the wife] or by his payments of premiums before his marriage to her in our opinion passed to the community when, after his marriage to [her], he paid the premiums out of community funds, made her the beneficiary, and increased the amount of the insurance to \$9,000. Under this state of facts the ownership of the proceeds of the certificate is to be determined in the same way as if the certificate had been issued after [the husband and wife] were married and all premiums paid out of community funds.

262 S.W.2d at 397.

Several commentators have viewed the case as indicating that the Texas Supreme Court might have accepted the risk payment doctrine for term insurance cases. Professor Huie observed:

the apportionment rule, Chief Justice Mallery dissented, arguing that the court should recognize that the "full value for all the monthly premiums except the last one was received by way of the protection enjoyed by the assured during the periods for which they were paid."¹⁰⁵ There has been surprisingly little discussion of the risk payment doctrine by commentators.¹⁰⁶

The risk payment approach also is fairer than the other doctrines in valuation of the insurability right. Under the inception of title rule insurability is not a factor, and the apportionment doctrine rests on the faulty assumption that uninsurability occurs during the period when the previous estate was paying for the policy. The risk payment doctrine, however, rests on a more plausible assumption, *i.e.*, that the insured spouse is more likely to become uninsurable while the subsequent estate is paying premiums than when the previous estate was paying them.¹⁰⁷ Accordingly, the risk payment doctrine denies the previous estate any compensation for insurability.¹⁰⁸

When term insurance is being renewed periodically, the transactions can properly be analyzed as the formation of a new contract as each renewal occurs. If that was the case in *Sherman v. Roe*, as it seems to have been, the court was entirely justified in treating the contract in controversy as one that was formed during the . . . marriage and paid for entirely with . . . community funds.

Huie, *Community Property and Life Insurance—Substantive Aspects—Developments in Texas*, 2 TEXAS INST. 104, 128 (1957). See also S. SCOVILLE, COMMUNITY PROPERTY RIGHTS IN LIFE INSURANCE 103 (1969); Note, 18 SW. L.J. 521 n.2 (1964); Note, 42 TEXAS L. REV. 747, 750 & n.24 (1964). The inception of title rule was adopted in Texas ten years later for use with cash value policies. See note 22 and accompanying text *supra*.

104. 27 Wn. 2d 176, 177 P.2d 391 (1947).

105. *Id.* at 185, 177 P.2d at 395 (Mallery, J., dissenting).

106. See Gilchrist, *Washington Disinherits the Non-Native Wife*, 46 WASH. L. REV. 283, 295-95 & n.66 (1971) (risk payment doctrine discussed in one paragraph and a footnote); Huie, *supra* note 103, at 104, 109-10, 217-28 (1957) (risk payment doctrine discussed in two paragraphs); Jackson, *Community Property and Federal Taxes*, 12 SW. L.J. 1, 44 (1958) (risk payment doctrine discussed in one paragraph); Note, 18 SW. L.J. 521 n.2 (1964) (risk payment doctrine discussed in a footnote); Note, 42 TEXAS L. REV. 747, 750 & n.24 (1964) (risk payment doctrine discussed in one paragraph and a footnote).

107. See note 84 and accompanying text *supra*.

108. The majority of people in the United States are not uninsurable. Less than three percent of those who apply for life insurance are turned down for health reasons. In addition, five percent of the total number of applicants for life insurance are insurable at a rate higher than the standard rate, mainly because of some medical reason. LIFE INSURANCE FACT BOOK at 91-92. The actual number of uninsurable persons in the population is probably greater than three percent, however, because the infirm and aged may not apply for life insurance on the assumption that they would be unable to obtain it.

It should be noted also that most group term and credit life insurance is issued without evidence of insurability. Gregg, *Fundamental Characteristics of Group Insurance*, in LIFE AND HEALTH INSURANCE HANDBOOK 351, 352 (3d ed. D. Gregg & V. Lucas

There is current support for the risk payment doctrine's denial of reimbursement to the previous estate for the insurability right. Both state¹⁰⁹ and federal¹¹⁰ governments have recognized that for estate, gift, and inheritance tax purposes insurability is not a factor in determining the value of a life insurance policy. Insurability is too difficult to value. In the divorce-property disposition context, the courts also have not attempted to value the insurability right; instead they have looked only to the cash value.¹¹¹ Therefore, if courts do not value insurability for tax and property settlement purposes, they should not purport to do so when characterizing insurance proceeds as either separate or community.

However, if courts choose to value insurability, the risk payment doctrine can be modified to accommodate this purpose. This could be accomplished in a number of ways. A court could assume that every insured is uninsurable at the time he brings his policy into the marital

1973); Huey, *Individual Insurance Marketing*, in *id.* 964, 974; Williams, *Group Life Insurance*, in *id.* 372, 379. See notes 85 & 86 and accompanying text *supra*. Group life and credit life insurance accounted for more than 47% of the face amount of all life insurance in force in the United States at the end of 1974. LIFE INSURANCE FACT BOOK at 22. Considering the fact that the incidence of group life insurance is growing at a faster rate than that of cash value insurance, the majority of insurance issued in the future in the United States may be issued without evidence of insurability.

109. At the death of the noninsured spouse, the noninsured spouse's one-half interest in a policy purchased with community funds is, for state inheritance tax purposes, measured by the value of one-half of the cash surrender value. No value is given to any right of insurability. See *In re Mendenhall's Estate*, 182 Cal. App. 2d 441, 6 Cal. Rptr. 45 (1960); *In re Leuthold's Estate*, 52 Wn. 2d 299, 324 P.2d 1103 (1958); *Thompson v. Calvert*, 301 S.W.2d 496 (Tex. Civ. App. 1957).

110. At the death of the noninsured spouse, the noninsured spouse's one-half interest in a policy purchased with community funds is, for federal estate tax purposes, one-half of the interpolated terminal reserve value of the policy as determined under Treas. Reg. § 20.2031-8 (1974). Rev. Rul. 75-100, 1975 INT. REV. BULL. No. 12, at 15. No value is given to any right of insurability. See also note 139 *infra* (federal government is not willing to value insurability); Treas. Reg. § 25.2512-6 (1974) (gift tax); G. LOWNDES, R. KRAMER & J. MCCORD, *FEDERAL ESTATE AND GIFT TAXES* § 18.35, at 545 (3d ed. 1974). But see *James S. Pritchard*, 4 T.C. 204 (1944).

111. See, e.g., *Wills v. Wills*, 50 Wn. 2d 439, 441, 312 P.2d 661, 662 (1957); *Pollock v. Pollock*, 7 Wn. App. 394, 403, 499 P.2d 231, 237 (1972). Upon divorce some courts value the noninsured spouse's portion of a community property life insurance policy at one-half the cash value. No attempt has been made at valuing the insurability right of the insured, or even recognizing that there is such a right. See *Milhan v. Milhan*, 13 Cal. 3d 129, 132-33, 528 P.2d 1145, 1147, 117 Cal. Rptr. 809, 811 (1974); *Arnold v. Arnold*, 76 Cal. 2d 877, 174 P.2d 674, 679 (1946); *Womack v. Womack*, 141 Tex. 299, 172 S.W.2d 307, 308 (1943); *Locke v. Locke*, 143 S.W.2d 637, 638 (Tex. Civ. App. 1940); *Russell v. Russell*, 79 S.W.2d 639, 641 (Tex. Civ. App. 1934). Where the policy is without cash value, no value has been assigned to the policy upon divorce. See *Smith v. Succession of Smith*, 298 So. 2d 146, 149 (La. App. 1974). Other courts which have measured the community interest in life insurance policies at divorce have neither recognized nor valued the insurability right. See note 127 *infra*.

community.¹¹² Upon death, it could then compensate the separate estate by allocating to it a fixed percentage of the proceeds, for instance, ten percent.¹¹³ This approach is simple and avoids a trial on the insur-

112. For purposes of this discussion of insurability, it is assumed that the prior estate is the separate estate and the subsequent estate is the community estate. This has been the most common fact pattern. However, the discussion also can be applied to the converse situation, *i.e.*, where the prior estate is community and the subsequent estate is separate.

113. This figure represents a suggested value of the insurability right in a term policy valued at its cost to the policyholder. This is the cost of renewability and convertibility options contained in the term policy, which options allow one to maintain coverage regardless of any future deterioration in his health. Although selection of the ten percent figure is arbitrary, it is not without a reasonable basis. In arriving at this figure, both the costs of renewability and convertibility for term insurance policies were considered.

To determine the cost of renewability, the author compared the published premium rates of term policies having only a convertibility feature with those having both renewability and convertibility features. See BEST'S FLITCRAFT COMPEND, *supra* note 41, which lists seven companies that publish their rates for convertible only and for renewable and convertible level term policies. The average difference of premium rates was four percent, which indicates the cost of those companies' renewability options. *Id.* at 190, 416, 470, 492, 518, 716, 742. Nonparticipating policies (ones which do not pay dividends) were chosen for this price comparison because of the possibility that premiums on participating policies may only partially reflect the necessary costs of renewability and convertibility, a portion of those costs being reflected in the amount of annual dividends paid. See J. Higbee, Survey of Actuaries Regarding Renewability and Convertibility Costs in Term Life Insurance Policies 3, 21, 25, 37, 40, 46 (1975) (unpublished collection of responses to a questionnaire mailed to actuaries of the 80 largest life insurance companies in the United States, on file in the University of Washington Law Library) [hereinafter cited as Survey]. Interestingly, the average cost of renewability as a percentage of premium, as reported by the insurance companies surveyed, was also four per cent. Survey at 19, 25, 43, 47. However, it is not necessarily true that premiums for a renewable policy are greater than those for a nonrenewable policy. A renewable policy may be less expensive because it provides a longer period of time over which to amortize acquisition costs. Survey at 10, 16, 46 (appendix I, at 18-19).

Convertibility costs were more difficult to obtain. Because few companies sell policies without convertibility features, a comparison of term policy rates was inadequate for determining the cost of convertibility. Actuaries' replies to the author's questionnaire, however, did yield definite figures. Their reports of convertibility costs, as an average of premium payments, ranged from zero to eleven per cent and averaged five per cent. Survey at iv, 4, 19, 20, 25, 36, 43, 47. The company reporting a zero cost of convertibility assumed "that when a term policy is converted to permanent coverage, the expense saving will offset any extra mortality." *Id.* at 20. Elimination of the need for a medical examination saves the company money. Also, a company may pay a lower commission to its salespeople on converted policies. See 20 TRANSACTIONS OF THE SOC'Y OF ACTUARIES D692 (1968); 1 TRANSACTIONS OF THE SOC'Y OF ACTUARIES 207, 217 (1947). One major United States life insurance company reported that it charges an average of five percent for the combination of renewability and convertibility features. Survey at 46.

Renewability and convertibility costs also could be determined by separating them from each premium payment and accumulating them with interest. Such calculations can be found in actuarial literature. At age 60 the resultant fund would be approximately \$100 for each \$1,000 of face value, or ten percent. See Huntington, *Derivation of Premium Rates for Renewable Term Insurance*, Table 2, 10 TRANSACTIONS OF THE SOC'Y OF ACTUARIES 329, 340 (1959); Survey at 12. See also Survey at 16.

ability issue; however, it is based on an assumption that frequently will be invalid. Alternatively, the issue could be tried in court in order to avoid a conclusive presumption of uninsurability. The burden of proving uninsurability could be placed upon the heirs of the separate estate or the beneficiaries under any claimed separate portion of the policy. If they meet their burden of proof, the court could either allocate a fixed percentage of the proceeds to the separate estate or place an appropriate value on the insurability right as of the date of marriage.¹¹⁴

Although this discussion has not included an exhaustive study of the cost of renewability and convertibility features, it does indicate that the cost of such features is small in comparison to total premiums paid. Indeed, there are several different methods for computing such costs, and the authorities are not in complete agreement as to the most appropriate method and the underlying assumptions. See, e.g., Fassel, *Term Conversion Option*, 1 TRANSACTIONS OF THE SOC'Y OF ACTUARIES 177 (1949); Huntington, *supra*, and *Gross Premium Rates for Renewable Term Insurance*, 12 TRANSACTIONS OF THE SOC'Y OF ACTUARIES 526 (1961); Ziock, *Gross Premiums for Term Insurance with Varying Benefits and Premiums*, 22 TRANSACTIONS OF THE SOC'Y OF ACTUARIES 19 (1970); Survey at 1, 19, 26-26A.

The figure ten per cent is suggested to represent the average cost of insurability to one holding a renewable and convertible policy. It has been shown that, on an average, ten percent of premium payments are for renewability and convertibility costs and that ten percent of the face value of a term policy is a reasonable approximation of the actual fund contributed by the insured to pay for his renewability and convertibility costs. It should not be objectionable that this figure is an average, and as such, is not adjusted for particular cases, because courts have commonly used the cash values of whole life policies without adjusting them to reflect the insurability status of the insured. Cash value is only an average value as the actual value of any policy may be greater or lesser than its cash value. Survey at 34. Finally, it is submitted that although not all term policies are renewable or convertible, or both, a term policy for more than one year, in essence, gives the insured a valuable "right to renew" for each year during the term. Survey at 30. Therefore, the ten percent figure should be applied to all term policies, whether neither renewable nor convertible, as an approximate measure of the cost of insurability to the insured.

114. After the insured has become uninsurable or has died, it is not uncommon for courts to be called upon to value life insurance policies. For instance, when a company has been found to have wrongfully cancelled a policy and the insured is no longer insurable, courts have held that the value of the policy is the present value of its face amount, based upon the insured's life expectancy, less the present value of premiums which would have been paid during that time. *Continental Assurance Co. v. Supreme Constr. Corp.*, 375 F.2d 378, 384 (5th Cir. 1967) (trial court determined value of policy, under Texas law, as of a point in time three years prior to trial when insured was in poor health and where he had died one year prior to trial); *National Life & Accident Ins. Co. v. Johnson*, 154 S.W.2d 219 (Tex. Civ. App. 1941) (valuation of two policies for living, but uninsurable, insured); *Franklin v. Northern Life Ins. Co.*, 4 Wn. 2d 541, 563, 104 P.2d 310, 320, 322-23 (1940) (valuation of group-term policy for living, but uninsurable, insured). See also *Caminetti v. Manierre*, 23 Cal. 2d 94, 142 P.2d 741, 747 (1943)(dictum); Annot., 34 A.L.R.3d 245, 335-36, 373-75 (1970); *Mather, Measure of Damages for Wrongful Repudiation of Executory Life Insurance Contracts in Texas*, 12 TEXAS L. REV. 251, 267-69 (1934).

Commentators have suggested that, upon divorce, the actual value of the policy, including its value resulting from uninsurability of the insured, be considered when

Another advantage of the risk payment doctrine is that it protects the noninsured spouse from constructive fraud.¹¹⁵ Under the risk payment doctrine, the noninsured spouse is entitled to one-half the term insurance proceeds if community funds were used to pay the most recent premium. Thus, the noninsured spouse cannot be precluded from receiving proceeds, as would occur under the inception of title doctrine which limits recovery to one-half of the community premiums exclusive of interest. Nor could he or she be limited to a fraction of the face amount, as is the case under the apportionment rule, where the community had paid the last several premiums on a policy which had been in force years before the marriage.

There is a potential for inequity under the risk payment doctrine where the spouses have divorced and the insurance policy was not disposed of during the property settlement. For instance, if the insured spouse paid premiums with separate funds after divorce, the risk payment rule would allocate all of the proceeds to that spouse's separate estate.¹¹⁶ However, the doctrine need not lead to an unfair result because there are remedies available to the noninsured former spouse

making a property settlement. Huie, *Community Property Law as Applied to Life Insurance*, 17 TEXAS L. REV. 121, 142-43 (1939); Comment, *Insurance and the Community*, 25 LA. L. REV. 492, 504-05 (1965). The actual value of the policy takes into account the insured's health and is calculated in the manner indicated in *Continental Assurance*, *supra*. Actuaries have generally agreed that this method is the most accurate. Survey at 3, 18, 23, 39. If the insured is insurable, but at an increased risk and premium because of deteriorating health, the actual value of the policy would be the present value of the premiums for a new policy less the present value of the remaining premiums on the insured's present policy. Survey at 9, 17, 35, 42, 47. However, the most simple method for dividing life insurance upon divorce may be division of the policy into two separate policies. Insurance companies are usually willing to do this. Thurman, *Federal Estate and Gift Taxation of Community Property*, 1 ARIZ. L. REV. 253, 273 (1959).

115. See note 40 and accompanying text *supra*. It may be contended that the risk payment doctrine could operate unfairly by allowing a married insured to shift the proceeds of a life insurance policy to the benefit of his separate estate by paying the last premium before death with his separate funds. The doctrines of actual and constructive fraud should prevent this however. For a discussion of the constructive fraud doctrine in a community property life insurance setting, see *Davis v. Prudential Life Ins. Co. of America*, 331 F.2d 346, 351-52 (5th Cir. 1964); *Givens v. Girard Life Ins. Co. of America*, 480 S.W.2d 421 (Tex. Civ. App. 1972). No fraud problem with the use of the apportionment doctrine has arisen even though an insured paying premiums out of separate funds subsequent to marriage may thereby increase his share of the policy proceeds in derogation of the community interest.

116. Where community property life insurance has not been included in the settlement at the time of divorce, the ex-spouses should own the policy as tenants in common for as long as the last community premium is paying for the protection element. When the first post-divorce (separate) premium payment is made, the risk portion of the policy should be deemed separate property, although the community will still have an interest in the cash value, if any.

to recover an appropriate share of the proceeds. He or she may have an action in fraud¹¹⁷ or conversion against the insured spouse for concealing the policy at the time of divorce or against the noninsured spouse's attorney for malpractice in neglecting to inquire as to the existence and character of life insurance.¹¹⁸ In such a suit, the appropriate measure of damages should be the same amount that would have been recovered if the policy had been divided at divorce.¹¹⁹

B. The Risk Payment Doctrine and Cash Value Insurance

The risk payment doctrine should be applied to cash value as well as term insurance. Cash value policies are separable into a temporary risk (or protection) portion and a permanent savings portion.¹²⁰ The

117. See Annot. 152 A.L.R. 190 (1944)(misrepresentation of the financial status of a spouse as grounds for relief from the divorce decree property settlement).

118. See *Smith v. Lewis*, 13 Cal. 3d 349, 530 P.2d 589, 118 Cal. Rptr. 621 (1975)), in which the former wife sued her divorce attorney for negligence in failing to assert her community interest in the retirement benefits of her husband. She won a judgment of \$100,000 in this action.

119. Upon request insurance companies will split a single policy into two separate policies. Thurman, *supra* note 114. If it is assumed that the divorce court would have divided the policy evenly, with each ex-spouse responsible for his or her half, an appropriate measure of damages would be one-half the face value of the policy less one-half the total amount of separate premiums paid. For example, assume the community paid \$150 per year for seven years for a \$10,000 policy of insurance, after which there was a divorce and the husband fraudulently concealed the policy from the wife's attorney and the court. Assume also that he died three years after the divorce, having paid three annual premiums from his separate funds. In this hypothetical, the wife's recovery would be \$4,775: one-half the face amount of the policy (\$5,000), less one-half the separate premiums the husband paid for three years ($\frac{1}{2} \times 3 \text{ years} \times \$150/\text{year} = \$225$). One-half the premium (\$225) is the same amount she would have had to pay to keep her half of the policy in force had it been divided at the time of divorce. In this situation, the principle and effect are the same whether term or cash value policies are involved.

Courts may avoid the issue of whose fault it was that the policy was not disposed of in the divorce decree by limiting the recovery of the noninsured spouse to one-half the face value minus one-half the premiums subsequently paid by the insured surviving spouse cumulated at 8% compound interest. The premium payment by the insured spouse is treated as a loan to the noninsured spouse, yet part of each premium payment is recognized as paying for the protection element of the policy.

120. See notes 14 & 15 and accompanying text *supra*, and notes 126, 138 & 139 *infra*. It may be argued that it is incorrect to think of the policy as consisting of two components and consider the cash value as a savings account owned by the policyowner because the cash value is not his money, but belongs to the insurance company, which holds it and invests it as a reserve. However, from a realistic economic standpoint, the cash surrender value is an asset of the insured. See J. BELTH, *THE RETAIL PRICE STRUCTURE IN AMERICAN LIFE INSURANCE* 33-35 (1966). Furthermore, the reserve element of the life insurance policy, upon which the cash value is based, is carried on the books of the life insurance company as a liability as it represents an obligation to the insured. See J. MACLEAN, *supra* note 10, at 14, 111 n.1. See also J. No-

risk payment doctrine should be applied to the risk component of the cash value policy, while the cash value portion should be apportioned between the estates¹²¹ according to the number of years each had contributed premiums.¹²² The labels term or cash value should make no

BACK, LIFE INSURANCE ACCOUNTING 115 (1969). The United States Supreme Court has stated:

[T]he courts have long recognized that the surplus of the paid premiums accumulated to make up the cash surrender value should be treated for some purposes as though in fact a "fund" held by the insurer for the benefit of the insured. Judge Addison Brown stated in *In re McKinney*, 15 F. 535, 537 [S.D.N.Y. 1883]:

"Though this excess of premiums paid is legally the sole property of the company, still in *practical effect* though not in law, it is *moneys of the assured deposited with the company* in advance to make up the deficiency in later premiums So long as the policy remains in force the company has not practically any beneficial interest in it, except as its custodian, with the obligation to maintain it unimpaired and suitably invested for the benefit of the insured. This is the *practical*, though not the legal, relation of the company to this fund."

. . . Thus in *economic reality* the insurer pays the beneficiary the insured's "fund," plus another amount sufficient to perform the insurer's promise to pay the proceeds on the insured's death.

United States v. Bess, 357 U.S. 51, 59 (1958)(emphasis added, citations omitted). See *Burlingham v. Crouse*, 228 U.S. 459, 469 (1913); *Hiscock v. Mertens*, 205 U.S. 202, 211 (1907); *United States v. Behrens*, 230 F.2d 504, 507 (2d Cir. 1956); *Rowen v. Commissioner*, 215 F.2d 641, 647 (2d Cir. 1954); *Stephens*, *supra* note 15, at 353 n.20. In *Bess* the Court held that a tax lien effected during an insured's life against the cash surrender value of his life insurance policy attached after his death to the proceeds in the hands of the beneficiary in the amount of the cash surrender value. For a discussion of possible motives as to why some are opposed to considering a cash value policy as separable into savings and protection components, see J. BELTH, *supra* at 34-35; THE CONSUMERS UNION REPORT ON LIFE INSURANCE 16-17 (rev. ed. 1972); N. DACEY, *supra* note 84, at 167, 176.

121. It may be asked why the cash value is apportioned rather than apportioning another of the nonforfeiture values to which the insured is entitled upon termination of his policy, such as the face amount of either the paid-up life or the extended term options. The cash value was chosen because it represents the equity built up in the policy and is a monetary measure of the worth of each of the nonforfeiture options available to the terminating policyholder. Thus, the face amount of the paid-up life option and the length of time of protection under the extended term option depend on how large the cash value is at termination of the policy.

122. For example, assume a single person purchases a \$10,000 nonparticipating whole life policy and pays five annual premiums before marriage and fifteen annual premiums after marriage. Upon death of the insured 20 years later, the cash value may be \$2,000. The cash value would be apportioned according to the nature of the property used to pay the premiums: one-fourth (5/20) would be characterized as separate property, and three-fourths (15/20) would be characterized as community property. The risk portion of the policy, *i.e.*, the face value (\$10,000) less the cash value (\$2,000), \$8,000, would be characterized according to whether separate or community funds were used to pay the final premium.

If a participating (dividend-paying) policy is involved, the calculations required are somewhat more involved, though not overly complex. For example, assume that an insured died after having paid his twentieth premium on a \$10,000 participating policy, and that throughout the life of the policy, the dividends had been used to reduce the annual premium payments. Assume that the gross annual premium is \$200, and that at the time of the twentieth premium the dividend was \$80, thereby reducing the net

difference in application of the risk payment doctrine¹²³ because some term policies actually have a cash value¹²⁴ while some cash value poli-

premium cost to \$120. Assume also that the insured had been single for 15 years and had been married for 5 years before his death. Because the \$80 dividend was paid as a result of 15 years' premium payments from separate funds and 5 years' premium payments from community funds, the source of three-fourths (15/20) of the dividend, *i.e.*, \$60, is attributed to the separate premium payments. The balance (\$20) is deemed to have been paid with community funds. Therefore, the \$200 gross premium has been paid with \$60 separate funds and \$140 community funds. Accordingly, 30% of the protection element should be deemed separate property and 70% community property. A sum equal to $15/20 + (.30 \times 5/20)$ of the cash value should be characterized as separate property, the remainder being community property.

If the dividends in the previous example are not applied against the gross premium, the calculations are much simpler. If paid-up additions (small amounts of paid-up life insurance) had been purchased with the annual dividends attributable to premiums paid with separate funds, the paid-up additions should be characterized as separate property. The remaining paid-up additions are, of course, community property. If the annual premiums were used to buy one-year term insurance, the character of the proceeds of that insurance would depend on the character of the last premium payment. If the annual dividends had been left with the community to accumulate interest as a separate fund, then that fund should be treated as a savings account. In these situations, the cash value should be apportioned as if a nonparticipating policy were involved.

It is recognized that earlier contributions to the cash value through premium payments will have contributed a greater share to the total cash value than apportionment recognizes because of the effect of compound interest. However, the complexity of actuarial calculations required to allocate a proportionately greater share of the cash value to the earlier premium payment prohibits their use, especially since most policies do not have any cash value during the first years they are in force because most of the first premium payment goes for selling expenses. Slight inaccuracies in this approach may occur because some of the cash value, or the interest thereon, may be combined with the premium payments in later years to pay for the risk of death. Because the risk of death is greater the older the insured, the premium payments alone may not cover the entire risk. Even in years when this happens, however, the cash value still grows as a result of compound interest.

If a premium loan provision (enabling an insured to borrow from his accumulated cash value to pay premiums) is providing for the payment of premiums at the time of the insured's death, then the proceeds should be characterized as separate or community in the same proportion that each estate is deemed to have contributed to the cash value, for the cash value is the source of the premiums. Similarly, if the policy is paid up (whether by reason of a nonforfeiture provision or through a limited-payment life policy) or if the policy is of the extended term variety under the nonforfeiture provision, the insurance proceeds should be characterized as separate and community property in the same proportions that each estate was deemed to have contributed to the cash value.

123. If a term policy has cash value, such cash value should be apportioned between the separate and community estates and the risk (or protection) portion should be characterized according to the source of the last premium payment. Similarly, if a cash value policy has no cash value, it should be treated as a pure term policy.

124. Although as a general rule term policies do not accumulate cash values, some level term policies, such as level term-to-age-65, commonly have small cash value elements which enable the insurer to charge a level premium and have a level face amount over an extended period of time. Part of the cash value in such policies is used in later years to help pay for the risk portion. The cash value is built up during the earlier years and is diminished in later years. When the policy expires at age 65 there is no residual cash value. See S. HUEBNER & K. BLACK, JR., *supra* note 14, at 78, 79.

cies do not.¹²⁵ The important consideration is the actual composition of the policy proceeds at the death of the insured, *i.e.*, how much of the proceeds is attributable to a cash value component and how much is attributable to the protection component.

The Washington Supreme Court has accepted the view that cash value insurance is a combination of both savings and protection elements.¹²⁶ Moreover, several courts have recognized that where insur-

125. If all the cash value has been borrowed, a cash value policy resembles a term policy. Also, it is common for cash value policies to have no cash value during the first two or three years. *See, e.g.*, the tables for common cash value policies in BEST'S FLITCRAFT COMPEND, *supra* note 41, at 155. The insurance law in each of the community property states does not require cash value policies to have cash value until after three full years of premiums have been paid. *See* ARIZ. REV. STAT. ANN. § 20-1231(B)(2) (Supp. 1974-75); CAL. INS. CODE § 10160(b) (West 1972); IDAHO CODE § 41-1927(2)(b) (Supp. 1975); LA. REV. STAT. ANN. § 22:168(A)(2) (West Supp. 1975); NEV. REV. STAT. § 688A.290(2)(b) (1973); N.M. STAT. ANN. § 58-8-3(2) (Supp. 1973); TEX. INS. CODE ANN. art. 3.44a, § 2(2) (Supp. 1974-75); WASH. REV. CODE § 48.23.350(2)(b) (1974).

126. In *In re Leuthold's Estate*, 52 Wn. 2d 299, 324 P.2d 1103 (1958), the Washington Supreme Court held that a decedent spouse's one-half interest in the cash surrender value of a community life insurance policy insuring the life of the surviving spouse is taxable under the Washington inheritance tax statute. Concerning the nature of a cash value policy, the court first quoted with approval from a well-known insurance text, J. MACLEAN, LIFE INSURANCE 11, 13 (8th ed. 1957), and then summarized the character of such a policy:

"Comparing a level-premium plan with a yearly-renewable-term policy of the same face amount, we note that under the former, when a policyholder dies, the accumulated reserve on his policy will, of course, be available as part of the 'face amount' payable. Consequently, as the reserve increases, the insurance, or *amount at risk* (face amount less reserve), decreases. Thus the increasing death rate is offset by a decreasing effective *amount of insurance*, and the cost is kept down to a practicable figure.

... It is very important to note that under the level-premium plan a policy of \$1,000 does not give actual *insurance* of \$1,000, (*i.e.*, the company is never 'on the risk' for that amount) but only of \$1,000 less the policyholder's own accumulated excess payments. It is thus evident, as already pointed out, that the plan is not pure insurance but rather a combination of a decreasing insurance with an increasing investment, the two amounts being computed mathematically in such a way that in any year their *sum* is equal to the 'face amount' payable under the policy. Failure to grasp this simple fact has led to a great deal of misunderstanding of the level-premium plan. . . ."

As indicated in the above quotation from Maclean's treatise, life insurance companies set up an account for each policyholder in the same manner as a savings bank establishes an account for each depositor. As premiums are received, the insured's account is credited annually with the proper increase in its cash value. If an insured owns a one-thousand-dollar policy which has been in force for several years and has a cash value of six hundred dollars, and then dies, the insurer pays the beneficiary the sum of one thousand dollars. But, contrary to popular misconception, the insurer does not pay the whole one thousand dollars entirely out of its own funds. It pays the six hundred dollars which was owned by the insured at the time of his death (thus wiping out his cash value), plus four hundred dollars from net premiums paid in by other insured persons.

The situation in the present case is no different than if Mr. Leuthold had

ance has been paid for partly with separate and partly with community funds, the community has a pro rata interest in the cash value.¹²⁷ Thus, there is a current judicial basis for treating cash value policies according to the risk payment analysis.¹²⁸ All that need be added is the concept that the risk (or protection) portion of the policy is the property of the estate that paid for protection against the risk under which the insured died.¹²⁹

taken community funds and opened a savings account with a bank in his own name.

52 Wn. 2d at 303-04, 324 P.2d at 1106. Courts of other states have ruled in accordance with the holding in *Leuthold*. See note 109 *supra*.

127. In *Pollock v. Pollock*, 7 Wn. App. 394, 499 P.2d 231 (1972), the court modified the trial court's decree by increasing the wife's share of the community property. The court declared:

If post-marital payments came from community property, the community would have . . . a pro rata interest in the cash surrender value based on the total post-marital premium payments divided by the total premium payments made before and after marriage.

Id. at 403, 499 P.2d at 237. This rule has also been used in Texas. *Berdoll v. Berdoll*, 145 S.W.2d 227 (Tex. Civ. App. 1940). A rule similar to this has been approved by courts of Arizona and Louisiana. Those courts have held that the measure of the community interest in a separate policy at divorce is the increase in cash value of the policy resulting from payments made with community funds. See *Blaine v. Blaine*, 63 Ariz. 100, 159 P.2d 786, 790 (1945); *Connell v. Connell*, 316 So. 2d 421, 428-29 (La. App. 1975); *Butler v. Butler*, 228 So. 2d 339, 343 (La. App. 1969); *Broyles v. Broyles*, 215 So. 2d 526, 529 (La. App. 1968).

128. The courts of Arizona and Texas have accepted the concepts that (1) when life insurance has been paid partly with separate funds and partly with community funds, the community has a fractional interest in the cash value, see *id.*, and (2) the character of a pure protection (term) policy is determined according to the source of the last premium payment, see notes 100-03 and accompanying text *supra*. Therefore it would be easy for the courts of these states to combine both of these concepts and accept the risk payment doctrine for use with cash value insurance.

129. The risk payment doctrine is also applicable to federal estate tax problems concerning the amount of community-owned life insurance proceeds that should be included in the gross estate of an insured spouse who dies after the noninsured spouse. Because the successors in interest of the noninsured spouse receive a one-half ownership in the policy upon that spouse's death, this interest should be treated as a receipt of a life insurance policy of half the size. If so treated, it becomes the duty of the noninsured spouse's successors to contribute premiums necessary to keep one-half the policy in force. If they do so and the surviving spouse also continues to contribute premiums, then, upon death of the surviving spouse, one-half the proceeds will be characterized as owned by the successors and one-half by the surviving spouse. See, e.g., *Scott v. Commissioner*, 374 F.2d 154 (9th Cir. 1967). The *Scott* court applied the apportionment rule and came to the same conclusion that the risk payment doctrine would have if applied to the facts. See also Rev. Rul. 75-100, 1975 INT. REV. BULL. No. 12, at 15.

If the successors in interest of the deceased noninsured spouse do not contribute one-half of the premiums necessary to keep the policy in force, their half of the policy should be treated as having lapsed, with their rights limited to recovery of one-half of the former community's interest in the policy's cash value. See notes 116-19 and accompanying text *supra*. The surviving spouse, required to pay all subsequent premiums, would have the following interest characterized as his separate property and included in his gross estate on his death: the policy's face value less the

The risk payment doctrine, as applied to cash value life insurance, is doctrinally sound. It is consistent with the unique characteristics of cash value life insurance, which should be regarded as a hybrid type of property composed of an asset analogous to savings (cash value) and an asset that is basically term insurance (the protection element). The community property source doctrine¹³⁰ leads to apportionment of the cash value according to the number of years the community and separate estates paid premiums. The principle also leads to the conclusion that the ownership of the protection portion of the policy should be traced back to the source of the last premium payment. The risk payment doctrine recognizes the fact that cash value life insurance involves a series of unilateral contracts. As each contract is created by payment of a premium, the insurance company becomes obligated to pay the protection portion of the policy upon death of the insured. Actuaries have recognized that each year's insurance coverage in a cash value policy is in the nature of a renewal of the contract.¹³¹

interest of the deceased spouse's successors, which would be one-half the interpolated terminal reserve value of the policy at the death of the first spouse. Alternatively, if the successors of the deceased spouse had been precluded from paying half of the premiums by a wrongful act of the surviving spouse, their recovery would be one-half of the policy's face value less one-half of the premiums paid by the surviving spouse until his or her death. In place of using both of the above rules, the court could, regardless of the successors' intent or the surviving spouse's wrongful acts, limit the recovery of the noninsured spouse's successors to one-half the face value less half the premiums subsequently paid by the insured surviving spouse cumulated at 8% compound interest. This rule would treat the premium payment by the surviving spouse as a loan to the successors of the predeceasing noninsured spouse, yet recognize that part of each premium payment pays for the protection element of the policy.

Because the amount of life insurance proceeds included in the gross estates of decedents depends on each state's community property law, the risk payment doctrine is not currently useful if the particular jurisdiction in which the deceased was a resident has accepted either the apportionment rule or the inception of title rule. It is available for use, however, in Arizona, which has accepted the risk payment doctrine for term life insurance. Texas also may have accepted the risk payment doctrine for term insurance. See notes 100-03 and accompanying text *supra*. The risk payment doctrine could be utilized for federal estate tax questions concerning deceased Idaho and Nevada residents as these two states have not yet accepted either the apportionment or inception of title rule. The basic concepts of the risk payment doctrine are available for immediate use, however, by federal courts handling the estate tax problems of life insurance policies transferred in contemplation of death where premium payments subsequent to the transfer are made by the transferee. See INT. REV. CODE OF 1954, § 2035. If the transferee is paying for the risk at the time of death, the protection portion of the policy should not be considered as having been transferred in contemplation of death.

130. See notes 57-65 and accompanying text *supra*.

131. Actuaries W. MENGE & C. FISCHER, *THE MATHEMATICS OF LIFE INSURANCE* 98 (2d ed. 1965), state:

The major expenses incurred by a life insurance company in selling and issuing a policy must be met in the first policy year, while the expenses incurred in the

Application of the risk payment rule to cash value policies is also equitable. The noninsured spouse is protected against constructive fraud because he or she is entitled to one-half of the protection element of the policy where the community had paid for the insurance at the time of the insured's death, plus one-half of the community's cash value interest in the policy. The separate and community estate's proportionate interests in the cash value can be deemed to compensate those estates for any insurability value claimed,¹³² or the insurability question can be resolved by following the approaches suggested previously with respect to term insurance.¹³³

Perhaps a reason that the risk payment doctrine was not originally adopted when *Webb* (1875) and *Moseman* (1886) were decided is that the concept of a nonterm policy consisting of both a permanent cash value portion and a temporary protection portion was neither as well known nor as well accepted as it is today. This was due partially to the fact that many nonterm policies at that time had no cash value. It was not until 1906¹³⁴ in Louisiana and 1911¹³⁵ in California that laws were adopted which made it a legal requirement for such policies to have a cash surrender value,¹³⁶ although by that time most companies were guaranteeing cash values.¹³⁷ More recently, the notion that

renewal years (the policy years following the first policy year) are comparatively small.

See also *id.* at 100. A vice president and actuary of one of the largest insurance companies in the United States has written that "permanent cash value policies, such as whole life, may be viewed in one sense as renewable policies, since the continuation each year is at the option of the insured." Survey at 30.

132. This method would, in effect, place no value on the insurability privilege. See notes 107-10 and accompanying text *supra*. If this method were adopted, to be consistent any cash value in a term policy would be treated in the same manner as cash value in a cash value policy.

133. See notes 107-14 and accompanying text *supra*. Methods applicable to term insurance can be applied only to the protection portion of the policy, however, and not to the full amount of death proceeds, some of which will be attributable to the cash value. Thus, if the insurability right of a pure term policy (one without cash value) is valued at ten percent of the face amount, the insurability right of a cash value policy should be valued at ten percent of the risk (or protection) portion of the cash value policy. Ten percent of the protection portion represents the value of the right to be able to annually renew the protection portion of the cash value policy. Survey at 39A. Since the risk portion of a cash value policy decreases annually, the amount of the protection element in effect immediately before death should be the figure used in determining the value of the insurability right.

134. Act No. 193, [1906] La. Acts 346-48.

135. Ch. 666, § 1, [1911] Cal. Stat. 1272-73.

136. For a general history of cash surrender values in the law and in the American life insurance industry, see J. CUMMINS, DEVELOPMENT OF LIFE INSURANCE SURRENDER VALUES IN THE UNITED STATES 21, 27, 39, 71 (1973).

137. *Id.* at 39.

cash value insurance can be viewed as consisting of separable savings and protection portions has been widely accepted,¹³⁸ and has been endorsed by the Treasury Department.¹³⁹

138. Professors S. HUEBNER & K. BLACK, JR., *LIFE INSURANCE* (5th ed. 1958) state:

It might be worthwhile to note the justification for the changing view of life insurance contracts, and the reason why whole life contracts have not in the past emphasized the increasing investment, decreasing term insurance concept. In the early days of the business there were no nonforfeiture values under life insurance contracts. If an individual was forced, because of inability to pay or otherwise, to cease premium payments under his contract, no return of any sort was available to him as a matter of contract. The contract promised to pay in the event of the occurrence of death or survival to a certain age, but if the contract was dropped prior to the occurrence of these contingencies, all premiums were considered fully earned, and the reserve or savings element was forfeited. [Some companies did allow a cash value, but even here the policy usually contained no provision for them so that the policyholder had no right to any surrender value. The values when allowed were small and generally were granted only if application was made within a short period after lapse. . . .]

With the increasing emphasis on the living values in life insurance and because the economic approach is easier for the layman to understand and *produces identically the same results*, the legal interpretation of the contract has been modified accordingly; similarly, the economic concept of all permanent forms of life insurance has become increasingly accepted as the more logical explanation.

Id. at 82-83 & 72 n.1 (footnote material in brackets, emphasis added). The "economic approach" and "economic concept" of life insurance mentioned in the last paragraph quoted is the principle that cash value insurance can be divided into two parts: decreasing term insurance and increasing investment. *Id.* at 81.

Interestingly, in 1895 the community property jurisdiction of Quebec, Canada, enacted a statute that required that the risk payment doctrine be applied to certain life insurance policies. Act Respecting Life Insurance, 58 Vict. 86-87, c. 46, § 1 (Can.). Recently, the Act in which it was contained was replaced. Ch. 70, § 438, [1974] Quebec Stat. 683.

139. In U.S. TREASURY DEP'T, 91ST CONG., 1ST SESS., *TAX REFORM STUDIES AND PROPOSALS* (Comm. Print 1969), the Treasury Department suggested changes in the tax laws. Some of these suggestions were enacted into law in the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 (codified in scattered sections of 26 U.S.C.). One suggestion which was not then adopted by Congress was that the present estate tax rule dealing with transfers of life insurance in contemplation of death be changed:

There has been criticism of the present contemplation of death rules because they do not reflect what any given life insurance premium pays for. Each premium can be regarded as constituting three elements: The annual increase in the cash value of the policy, a loading charge, and the purchase of the protection element of the policy (essentially 1-year-term insurance).

In order to reflect the economic realities of life insurance, in this regard, the contemplation of death rules as applied to life insurance will be modified. If the insured transfers the incidents of ownership of a policy but makes any premium payments during the 3 years preceding death, a transfer in contemplation of death of a portion of the policy proceeds will be deemed to have been made. The value of the transfer at death will be the increase in cash value in the policy resulting from the premium payments so made plus the difference between the face amount of the policy and its cash value at date of death (the protection element of the policy).

IV. CONCLUSION

The inception of title and apportionment rules, both formulated during the nineteenth century, do not treat life insurance as a unique type of property. Only the risk payment doctrine recognizes that life insurance is a series of discrete unilateral contracts, that it is composed of both temporary and permanent elements, and that any rights under the policy should be analyzed with such principles in mind. Therefore, both the judiciary and the legislatures of community property states should accept the risk payment doctrine as the most logical and equitable of the three alternative methods of determining separate and community interests in life insurance proceeds.

V. ADDENDUM

After this comment went to press, the Idaho Supreme Court accepted the risk payment doctrine for use with term insurance. *Travelers Ins. Co. v. Johnson*, _____ Idaho _____, 544 P.2d 294 (1975). In this

For example, assume an insured transferred a \$10,000 policy to his son more than 3 years prior to death and paid all premiums due prior to his death. At date of death the policy has a cash surrender value of \$5,000. Three years prior to death the policy had a cash value of \$4,600. Under this rule, \$5,400 would be included in the decedent's gross estate—the \$5,000 in term insurance protection purchased with the last premium payment and the \$400 increase in cash value occasioned by the payment of the last three premiums.

Since term insurance generally has no cash value, each year's premium is the purchase of the protection equal to the face amount of the policy. Therefore, payment of a premium on a term policy within the 3 years preceding death will be a transfer in contemplation of death equal in value to the full face amount of the policy.

TAX REFORM STUDIES AND PROPOSALS, *supra*, pt. 3, at 374. Because of the fact the Treasury wanted this rule adopted, it is evident that it felt the splitting of cash value life insurance into savings and protection portions could be handled without undue administrative difficulty. Also, under this rule, the Treasury did not attempt to value the insurability right, leaving its value at zero.

Consider also the following language from Treasury publications in which it is recognized that, for practical purposes, the cash value policy is divisible into the protection and investment portions, and that each annual premium payment pays for both protection and an increase in cash value.

If the amount payable upon death at any time during the year exceeds the cash value of the insurance policy at the end of the year, the entire amount of such excess is considered current life insurance protection.

Treas. Reg. § 1.72-16(b)(3) (1963).

Under the "split dollar" arrangement, the employer and employee join in purchasing an insurance contract, in which there is a substantial investment element, on the life of the employee. The employer provides the funds to pay part of the annual premium to the extent of the increase in the cash surrender value each year, the employee pays the balance of the annual premium.

Rev. Rul. 64-328, 1964-2 CUM. BULL. 11-12.

case, after the husband and his first wife were divorced, the husband took out a group term life insurance policy and named his first wife as beneficiary. The first nine months' premiums were paid from his separate funds before his second marriage. He then married his second wife, paid premiums on the policy with community funds for ten and one-half years, and died.

The court considered and rejected the rationales behind both the inception of title and apportionment rules, refusing to hold either that a separate property interest in the policy vested at its issuance or that a community property interest vested as premiums were paid from community funds. Instead, the court held that rights in the policy proceeds did not vest until the insured died, for up until that time it was uncertain whether the community would still be paying premiums at the time of the insured's death. The result was that one-half of the proceeds were distributed to the beneficiary, for a spouse is deemed to have testamentary power over one-half of the community property at death. The other half of the proceeds were retained by the second wife.

*James M. Higbee**

* Third-year law student, University of Washington; B.S., 1973, Brigham Young University.